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THE REPARATION PLAN

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THE REPARATION PLAN

AN INTERPRETATION OF THE REPORTS OF
THE EXPERT COMMITTEES APPOINTED
BY THE REPARATION COMMISSION,
NOVEMBER 30, 1923

BY

HAROLD G. MOULTON
et al

WITH THE AID OF THE COUNCIL AND STAFF
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DIRECTOR'S PREFACE

THE appointment by the Reparation Commission on November 30, 1923, of two special investigating committees, marked the beginning of a new era in the handling of the reparation problem. One of these committees was instructed to consider the means of balancing the German budget and the measures to be taken to stabilize the currency. The other was asked to estimate the amount of German capital held abroad and to suggest means of bringing it back to Germany. The appointment of these committees was significant not only because of American participation, but also because of the tacit recognition of the fact that the Reparation Commission as constituted was unable to discover any way out of the impasse in which it found itself. The publication of the Committees' reports on April 9, 1924, naturally attracted universal attention, directed discussion into new channels, and opened the way to a new series of negotiations among the interested powers.

The purpose of this volume is threefold: First, to present in a concise form the economic analysis of the Committees and their recommendations for the administration of the plan; second, to discuss the significant economic issues involved in the new plan, and to focus attention upon the unsettled questions which await for solution; third, to preserve in

convenient form, suitably indexed, the reports of the Committees. The official English text of these, as published by the Reparation Commission, has been used.

The reader should bear in mind that the Expert Committees were concerned only with certain phases of the reparation problem. They were not supposed to inquire into the causes of the war, or the controversial questions which center around the Treaty of Versailles. They were not authorized to discuss the legality, the justification, or the practical results of the occupation of the Ruhr. They were instructed to study specific questions, and they adhered to their instructions. Their work must be appraised accordingly.

The author expresses his indebtedness to the Council and Staff of the Institute for criticism and suggestions. Cleona Lewis rendered invaluable aid, particularly in the preparation of Chapter III. C. E. McGuire was of assistance in connection with Chapter VI and, with Crittenden Marriott, he shouldered the burden of preparing the indices and seeing the manuscript through the press.

H. G. MOULTON.

WASHINGTON, D. C.,
June, 1924.

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THE REPARATION PLAN

INTRODUCTION

The report of the Expert Committees appointed by the Reparation Commission opens a new chapter in the history of the reparation problem. The confusion arising from the welter of charges and counter charges and the conflicting statements in official memoranda as to the facts and issues involved, has in considerable measure been dispelled. The plan advanced unquestionably raises the whole problem to a new plane of discussion and opens the way to a reign of common sense in the handling of the difficult issues involved. If administered in accordance with the guiding principles outlined by the Committees, the plan proposed may be evolved into as nearly a solution of this baffling problem as we can ever hope to get.

The significance of the report does not lie in the estimates of the sums that might under favorable circumstances be raised within Germany for reparation purposes. The analysis is noteworthy for its emphasis on controlling principles and conditions, and for the machinery recommended for the practical

administration of the plan. Stated in the simplest and briefest possible way, the plan embodies two principal features, as follows.

First, Germany is to raise certain stipulated amounts of revenue for reparation purposes, *provided* such sums can be procured from taxation and other sources without disorganizing the fiscal and currency system of the country. In case events show that Germany can not raise the sums specified, the annual schedule of payments into the reparation account is to be adjusted accordingly.

Second, the funds raised within Germany are to be transferred to the Allies, *provided* their transfer can be effected without unsettling the exchanges and producing adverse repercussions upon the currency and the budget of Germany, or without prejudicing the interests of the creditor countries themselves. In case it develops that the funds raised can not be transferred, further collections will be suspended.

The Committee estimate the sums that they think might be procured within Germany, if that country's prosperity is fully restored, but they venture no opinion as to the sums that might be transferred to the creditors. It is definitely recognized that real payments must consist of real wealth—money being only an instrumentality. It is pointed out, therefore, that Germany can pay debts to foreigners only by exporting goods or rendering services; and it is also recognized that Germany must have large imports of food and raw materials if her economic system is to function. Hence, the Committee make

the unpredictable excess of exports and of services rendered over the imports required the final measure of Germany's capacity to pay.

The payment into the reparation account within Germany constitutes the definitive act of the German government in meeting its financial obligations under the plan. The delivery problem is primarily the concern of a Transfer Committee acting for the Allied nations. To use figurative language, the reparation funds collected within Germany are to flow into a bank reservoir until a certain level is reached. Thereafter if those funds can not be drained off, through the medium of foreign bills of exchange arising out of an export surplus, no further accumulations within the reservoir are to be permitted. The amount that can be drawn off will govern the amount that is to flow in. The capacity to transfer wealth across German borders is recognized as the heart of the problem, and it is made the core of the experts' plan.

While the Committee have emphasized the economic conditions and principles that are of controlling importance and evolved the broad outline of an administrative plan, the reparation problem in all its aspects is far from settled. A new beginning merely has been made. A number of difficult questions will arise in connection with the administration of the Committee's plan, and numerous issues of vital significance—issues which can easily wreck the entire scheme—have as yet not been faced. If made the tool of politicians, the administrative machinery set up can be used to prevent rather than to promote

the solution of post-war problems, and the economic recovery of Europe.

The analysis which follows really consists of three parts. The first three chapters are primarily expository. They are intended to set forth, with little attempt at criticism, the salient features of the experts' own economic analysis and to describe the administrative agencies which are recommended. In Chapters IV and V an appraisal is made of certain phases of the economic analysis with a view to focus attention upon the central problems with which the administrators of the plan are shortly to be confronted. In the final chapter, attention is directed in a constructive way to the numerous unsettled aspects of the reparation problem.

CHAPTER I

THE ECONOMIC ANALYSIS

The first Committee of Experts, popularly known as the Dawes Committee, was invited by the Reparation Commission under date of November 30, 1923, to "consider the means of balancing the budget and the measures to be taken to stabilize the currency of Germany." The Committee began their sessions on January 14, 1924, and submitted their findings to the Reparation Commission on April 9, 1924.

Under the terms of reference the following questions were definitely excluded from consideration: (1) the amount that Germany has thus far paid in fulfilment of treaty and reparation obligations; (2) the reasons for the default of Germany on reparation payments; (3) the fixing of any total sum which Germany could or should pay; (4) a consideration of political guaranties and penalties intended to insure execution of plans; (5) the question of the military occupation of Germany by Allied armies.

Constructively, the task of the Committee was to devise ways and means of procuring from Germany the largest possible reparation payments. Stated in specific terms, two principal problems were submitted to the first Committee for solution: (1) the stabilization of the German currency; and (2) the

balancing of the German budget and the development of a surplus for reparation purposes. A third problem, that of balancing Germany's foreign trade and developing an export surplus, was not mentioned under the terms of reference; but in the Committee's investigation, as we shall see, this aspect of the problem is admitted to be closely interrelated with the other two problems and equally important with them.

In this first chapter an attempt is made to elucidate the essential features of the Committee's economic analysis, and to present the broad outlines of the reparation plan that is recommended. Discussion of the economic agencies and control devices suggested for the administration of the plan is reserved for the second chapter.

I. INTERRELATION OF CURRENCY, BUDGET, AND INTERNATIONAL BALANCE OF PAYMENTS

The most significant feature of the Committee's economic analysis is the recognition and the insistence that the currency, the budget, and the foreign trade of Germany are very closely related problems, and that the restoration of sound economic conditions in Germany can not be effected unless these interrelated problems are considered together. It is for this reason, moreover, that the Committee insist that their plan must be taken or rejected as "an indivisible whole."

The Committee point out first that a sound currency must depend fundamentally upon a stable or balanced budget, and that a balanced budget can

not be maintained if the currency is demoralized. In the words of the report:

It is self-evident that these problems are interdependent. The currency of a country can not remain stable unless its budget is normally balanced, for if expenditure continually exceeds receipts there will in time be no alternative to the printing of new notes to meet the excess; and the inflation will inevitably involve depreciation. On the other hand, the task of balancing a budget, unless the currency is relatively stable, is an impossible one, for a falling currency makes calculations both of receipts and expenses unreliable, and in particular causes a continual loss to the taxing authority through the necessary interval of time between assessment and collection. . . . Their interdependence must be consistently borne in mind. (Part I, No. IV.)

The Committee do not attempt to say in this connection which comes first in time sequence. They merely note that if for any reason the budget is unbalanced and paper notes are issued to meet the deficiency, the currency depreciates; and that in its turn a depreciating currency, due to whatever causes, disorganizes the administration of the fiscal machinery. The important point is that with each fall in the value of the currency, the government's expenses for the succeeding month increase beyond the estimates, while at the same time the sums collected do not expand proportionately.

The Committee recognize, second, that an unbalanced international trade will in time react disastrously both upon the currency and the budget. On this point the report states:

For the stability of a country's currency to be permanently maintained, not only must her budget be balanced, but her earnings from abroad must be equal to the payments she must make abroad, including not only payments for the goods she imports, but the sums paid in reparation. Nor can the balance of the budget itself be permanently maintained except on the same conditions. Loan operations may disguise the position—or postpone its practical results—but they can not alter it. If reparation can, and must, be provided by means of the inclusion of an item in the budget—i.e., by the collection of taxes in excess of internal expenditure—it can only be paid abroad by means of an economic surplus in the country's activities. (Part I, No. VIII(d).)

That is to say, if Germany has an unfavorable "balance of payments"—including, of course, both trade and service operations—the foreign exchanges, the currency, and the budget will all be affected. In other words, if Germany's income from exports, from interest on foreign investments, and from shipping, banking, and other services, is less than the total of imports to be paid for, plus the reparation obligations to be met, disastrous effects upon the entire economic and financial system are inevitable. If the already inadequate gold supply is exported for the purpose of meeting foreign payments, the value of German paper currency relatively to foreign money, as expressed in the exchanges, will naturally fall. The depreciation of the exchanges will be followed, though with a lag, by higher paper-money prices in Germany. And this, in turn, will lead to speculative activities, as well as to serious problems of adjusting the incomes of the

wage-earning and salaried groups to the changing situation. All this inevitably affects the budget unfavorably.

If, on the other hand, gold is not allowed to leave the country, and German paper money—as has been the case during the past few years—is sold in international markets for bills of exchange with which to meet external obligations, similar results follow. The increase in paper currency leads to a depreciation in its value, prices rise, and the developments already outlined follow.

The statement that “loan operations may disguise the position, or postpone its results” without altering it, is particularly significant. The Committee see clearly that it is possible for a nation without a favorable international balance to make payments for a time, by means of borrowed funds; but the borrowed funds themselves give rise to new obligations and thus increase rather than diminish the real burdens. Foreign loans may serve to tide a country over an emergency, but they can not obviate the necessity of a favorable balance of trade, if interest charges are to be met.

It is interesting to note that the Committee do not attribute *causal* significance to any one of these interrelated factors. It is apparently the Committee's view that budgetary, currency, and international trade conditions act and react upon one another.

II. THE CURRENCY PROBLEM

While keeping consistently in mind the inter-relation between the budget, the currency, and the international balance of payments, the Committee, of course, find it necessary to study each problem separately. With reference to the currency problem they hold that there is no possibility of restoring sound business and financial conditions within Germany unless the gold standard is ultimately reestablished. "A unified and stable currency," the Committee believe, "is necessary for the rehabilitation of German finances, the balancing of her budget, and the restoration of her foreign credit." They propose to establish a new central bank, with substantial reserves in the form of gold, foreign bills of exchange, and deposits in foreign banks. While the bank notes are not to be immediately redeemable in gold, it is hoped that the period of inconvertible currency will prove of comparatively short duration.

The present supply of gold or foreign bills in Germany is held to be inadequate for the purpose of providing a unified, stable currency,—hence the necessity for an international loan, the details of which will be discussed at a later place. It is also hoped that through the reforms instituted the bulk of the liquid funds in foreign countries belonging to German citizens may be attracted back to Germany. The Committee find that all the liquid funds available, either at home or abroad, plus the proceeds of a large international loan, are required to establish sound financial conditions and to put Germany in

such a position as to make reparation payments possible. It will be apparent from these considerations that the Committee clearly recognize that Germany should not pay anything at the present time either in gold or foreign bills of exchange, or by drawing upon foreign bank balances. To do so would only serve to demoralize further the whole German financial and economic situation.

III. THE BUDGET PROBLEM

The Committee's analysis of the budget problem involves: first, a consideration of controlling principles; and second, recommendations as to budgetary reforms, together with estimates of the surplus revenues that may be procured for reparation purposes. It should be pointed out at this place that the revenues for reparation account are to be derived only in part from the normal fiscal sources. Special contributions to the reparation account, as we shall show under Section V, are to come from the transport tax, and from certain railroad and industrial securities specifically pledged for the purpose.

The first and primary principle is that the German tax burden should be commensurate with that of Allied countries. In the Committee's words:

It is not open to dispute, as a simple principle of justice, and it is contemplated by the Treaty that the German people should be placed under a burden of taxation at least as heavy as that borne by the peoples of the Allied countries. No single person in Germany, whether speaking as an individual or representing any section of the nation, has failed to accept that principle when it has been

squarely put to him.* Any limitation upon it, if there is one, must be a limitation of practicability and general economic expediency in the interest of the Allies themselves. . . . The principle is, at the same time, economically just, for it is obviously unfair and in every way undesirable that the Allied taxpayer should be penalised by the fact either that taxes resulting from the war weigh more heavily upon him as a consumer, or that in competition in his business he should be handicapped by greater burdens on the costs of production, including wages, than his German competitor bears. (Part I, No. VIII (b).)

The second principle is that reparation payments should have a prior claim on German revenues.

We repudiate, of course, the view that Germany's full domestic demands constitute a first charge on her resources and that what is available for her Treaty obligations is merely the surplus revenue that she may be *willing* to realise.¹ (Part I, No. VIII (a).)

Accordingly, certain specific revenues are to be assigned to, and placed under the control of, Germany's creditors.

These revenues will furnish a collateral, but not a primary, security and we suggest that they should be the taxes on customs, alcohol, tobacco, beer, and sugar. . . . We propose for this purpose that they should pass directly into the hands of an impartial and effective control; that the Treaty payments should first be deducted by the controlling authority for the account of the Allies; and that Germany should only have the use for her own purposes of such balance as may remain. (Part I, No. XIV.)

Although the Committee thus insist that certain German revenues shall be controlled for purposes of

¹ Italics ours.

reparation payments, they do not believe that any elaborate system of detailed control over German fiscal affairs is desirable. On the contrary, they say:

We do not hesitate to reject as undesirable, for the purpose which all have in view, save in certain extreme events, any system which would involve directly or indirectly the virtual control of all Germany's revenue and expenditure. It would involve the controlling authority in responsibility for all financial troubles, and it might be a pretext for them. The use of this safeguard of general budgetary control should be reserved for the case of Germany's wilful failure to meet the obligations now laid upon her. . . . It is in our opinion not impossible to establish a system under which a combination of self-interest and latent pressure will suffice to assure sound financial administration. (Part I, No. XIV.)

The third principle is that Germany's own minimum domestic expenditures must take precedence over anything else.

If the prior obligation for reparation that is fixed for Germany to pay, together with an irreducible minimum for her own domestic expenditure, make up in a given year a sum beyond her taxable capacity, then budget instability at once ensues and currency instability is also probably involved. In that event, an adjustment of the Treaty obligations of the year is obviously the only course possible. The amount that can safely be fixed for reparation purposes tends therefore to be the difference between the maximum revenue and minimum expenditure for Germany's own needs. (Part I, No. VIII (a).)

In accordance with this principle, which in a sense contradicts the second one, it will be seen that if,

for any *good* reason—such as a failure of Germany to recover her economic prosperity or a temporary business depression—German revenues prove insufficient for minimum domestic requirements plus reparation payments, domestic requirements must be given precedence. Otherwise, it is seen that currency instability, budgetary disorganization, and a breakdown of the whole scheme would ensue.

The provision that certain revenues shall first be paid into the reparation account must, therefore, not be considered as an absolute guarantee. The advantage of the provision from the standpoint of the Allies is that it puts the burden of proof as to maximum revenue and minimum expenditure on the German government. Only if and when a good case can be established by the German government will the reparation requirements take second place to German budget requirements.

With these principles in mind we may now note the means by which the Committee hope that the budget may be balanced. In the problem are involved considerations both of government expenditures and increases of taxation revenues.

The administrative expenditures of the German government must be increased somewhat. This is definitely stated by the Committee in the quotation below:

It may be hoped, with some degree of confidence, that expenditure on unemployment will exhibit a notable decrease. The expenditure on the army is capable of reduction. An automatic decrease will make itself felt in the pension charge. It is not to be expected on the other

hand that sums thus saved on these or other heads will represent a net benefit to the budget. In particular, and this remark applies also to the budgets of the immediately succeeding years [that is, after 1925-26] increases in the salary charges of the Reich which can probably not be entirely offset by decreases in personnel must be anticipated. Some increase in expenditure must therefore be expected. (Part I, No. IX (A).)

It will be seen that the Committee thus answers indirectly the question whether, as has so often been contended, German administrative outlays have been unnecessarily large. The answer is that, whatever may be true of particular items, the aggregate has not been large enough.

The virtual elimination of the domestic public debt is regarded as a real benefit to the budget. The great reduction in the burden of the public debt through the process of inflation has removed from future budgets a large item which heretofore had to be reckoned with. In the budget of 1921-22, for example, interest and sinking fund charges on the public debt, constituted 15.4 per cent of the gross expenditures (both for the ordinary budget and for treaty fulfilment purposes). In the next fiscal year, as a result of increased inflation, this ratio was reduced to 4.2 per cent;¹ while in the provisional budget submitted for the year 1924-25, this item amounts to only about 2 per cent. The explanation of this is simply that the number of paper marks paid out in fulfilment of public debt obligations remains

¹ Compiled by the writer from Material for a Study of Germany's Economy, Currency, and Finances, p. 30, Berlin, 1924.

unchanged, except in so far as the floating debt increases, while other expenditures expand in rough proportion to the rise in prices.¹

The Committee recognize, however, that although the practical annihilation of the public debt through the process of inflation has lessened the sums that need to be raised for interest payments, the practical disappearance of the debt has by no means been a net gain to the nation. Indeed, the Committee throw some interesting light upon the contention so often made that the German nation has grown rich by obliterating its debts to itself.

The extinction of the German debt has after all been at the expense of her own nationals, who are her taxpayers: they have sustained as holders of German bonds, not only the burden which they have already escaped as taxpayers, but that which they would have borne in future years to meet the service of the internal debt if its value had not been destroyed by depreciation. . . . The loss incurred by individual holders of debt is exactly offset by a corresponding profit accruing to the taxpayers as a whole. (Part II, No. II (a).)

¹ The use of the term *annihilation* or *elimination* of the public debt—and the same applies to private debts—is not altogether accurate. As observed in the preceding paragraph, the bulk of the public debt has not been paid off; and the same is apparently true of a very considerable part of the state, municipal, industrial, and agricultural debts. The debts still stand, though their burden is now of negligible amount. The question has not yet been settled, however, as to what will occur when a new mark is created. Presumably, some sort of system will be worked out whereby the present outstanding bonds will be exchanged at the rate of perhaps a trillion to one for new bonds. Just how the budget will ultimately fare as a result of impending financial reorganization remains to be seen.

Thus, so far as the nation as a whole is concerned, the practical extinction of the domestic debt has not increased the wealth of the country at all. Notwithstanding this fact, it may still be true, however, that the practical elimination of the domestic debt has been of some slight benefit to the budget. If the government obligations were owned largely by the middle classes, the loss of interest receipts would not seriously affect the government's taxation revenues, which in the nature of things are derived largely from the wealthier classes. In view of the existence of indirect taxes, as well as of the doubt as to the real incidence of many of the other taxes, this point can not be pressed too far. The Committee has undoubtedly attached much more importance to it than their own analysis warrants. More will be said on this subject in Chapter III.

The budget improvement must come from a rapid recovery of German prosperity rather than from noteworthy changes in the tax system. The basic assumption underlying the budget of 1924-25 and also of subsequent years is stated as follows: "It should be most carefully noted that the budget is not made up to represent the financial expectations of actual existing conditions." The estimates are based on the assumption that several essential conditions will be realized:

- (1) That the bank of issue, which would stabilize the currency and serve as a basis for the granting of credits, be established and successful.

- (2) That the full development of German economic life should not be restricted by the severance of the

Ruhr and the Rhineland, and that Germany have complete control of the Ruhr economic system.

(3) That Germany enjoy complete freedom in her economic relations with other countries.

(4) That Germany completely recover her economic prosperity.

The first two of these conditions the Committee would regard as fulfilled, if the general recommendations of the report are accepted. With regard to the third, they understand that commercial freedom will be restored under the terms of the Treaty in less than 12 months' time.

With reference to the second condition, the Committee are very emphatic. They state:

We have been unable to find any practical means of ensuring permanent stability in budget and currency under these (existing) conditions. We have, therefore, been compelled to make the assumption that the fiscal and economic unity of the Reich will be restored and our whole report is based on this hypothesis. . . . Our forecasts are based on the assumption that economic activity will be unhampered and unaffected by any foreign organization other than the controls herein provided. (Part I No. II and No. III.)

The fourth assumption underlying the budget, namely, that of complete recovery of German economic prosperity, implies not only the reestablishment of sound conditions within Germany, but also a return of world-wide prosperity and the recovery by Germany of her foreign markets. The Committee state:

In order that the restoration of Germany may be definitive, the other nations must also return to the conditions requisite for their financial and economic existence and must likewise be enabled to carry on the normal exchange of goods on which the general prosperity depends. . . . A Germany whose economy had again become flourishing could not long resist a financial and economic crisis in the nations surrounding her. (Part I, No. IV.)

The fulfilment of the Committee's estimates thus assumes, by implication, a complete recovery of the world from the losses resulting from the World War and the disastrous years that have followed. Among other things it assumes by implication that Russia will be restored within the next few years as a great market for German goods. The estimates are also based on the assumption that the world in general will welcome a rapid return of Germany as a powerful competitor in world markets and will not through trade and tariff policies restrict German international trade. Unless these assumptions are borne out by the events, the budget estimates would, of course, have to be pretty thoroughly revised.

A budget moratorium is recommended. In order to facilitate the recovery of German prosperity, without which the schedule of payments laid down is deemed impossible, the Committee stipulate that none of the funds for reparation purposes are to come from the budget during the first two years. They believe that in the first two years, taken together, budgetary receipts should be sufficient to cover ordinary expenditures, but they express the fear that the anticipation of a compulsory liability for peace-

treaty charges might destroy the whole balance. They say:

It has been considered that if for two years the budget is relieved from Peace Treaty charges and a stable currency is reestablished, Germany ought in 1926 to be making rapid strides toward complete recovery, and should in three years, by 1928, reach a normal economic condition. . . . We have considered [the budget estimates for later years] in relation to the maximum probable rate at which the national income can be expected to grow from its present point and the maximum proportion of that growth which can successfully be absorbed in taxation. (Part I, No. IX (A, 3).)

The Committee make no specific stipulations for changes in taxation rates.

The Committee would desire to avoid being dogmatic as to the way in which a given sum should be raised by the German government. Having come to the conclusion that a given burden can be borne (assuming complete recovery of German prosperity) it is for Germany to suit her own conditions in prescribing the ways in which it shall be obtained. (Part II, No. III.)

They do make certain suggestions, however, chief among which are the establishment of a virtual tobacco monopoly with a view to increasing federal revenues, gradual increases of indirect taxes "as prosperity grows," a reduction of the turnover tax, increased taxes on motor transport, and higher death duties. They also urge the levy of back income taxes on the wealthy classes with a view to making up for the substantial escape from taxes by these

classes during the period of rapid inflation, and special taxes on those who have reaped windfall profits through being able to pay off mortgages and debts in practically worthless currency.

IV. SOME CONTROVERSIAL ISSUES

The Committee do not definitely undertake to answer the controversial questions with reference to Germany's default on reparation payments. While not specifically directed toward that end, their discussion, nevertheless, does throw light on certain of the issues involved. A few words must suffice with reference to each.

The first question is whether the German tax burden has been notoriously low with reference to other countries. With reference to taxation *rates*, the Committee do not contend that in general the schedules have been unduly low in view of the conditions prevailing, nor is any mention made of wilful evasions or notably lax administration. Certain taxes appear to the Committee to have been somewhat too low, and others appear too high; but they do not question the general level of rates.

It is, however, appropriately pointed out that the process of inflation, particularly in the years 1922 and 1923, served inevitably to reduce the direct burden of the taxes levied, and to increase the indirect burden of taxation upon the fixed-income and laboring classes. The Committee, however, make no attempt to ascertain whether the increased indirect tax burden upon the masses equalled the decreased

direct tax burden upon the classes. They merely point out that certain groups benefited, while others suffered.

They undertake no appraisal of the burden of taxation that has been borne by the German taxpayers—directly and indirectly—during the post-war years. They merely contend that—

We have reached the view that the “commensurate burden” principle for Germany, *when she is fully restored to economic prosperity*, would more than justify all the practical conclusions we have set down. . . . It is sufficient to register our united conviction that all our recommendations and suggestions are well within what can be morally justified on the principle of “commensurate burden.” (Part II, No. II (a).)¹

The second question is whether the depreciation of the German currency was deliberate or unavoidable. The Committee point out that the German government and German banks have sold large quantities of paper marks to foreigners, but they nowhere contend that currency inflation could have been avoided under the conditions then existing. The German currency inflation they hold to be inextricably related to budgetary and international trade deficits. If Germany had been able to obtain a surplus in her budget and an export surplus she could have prevented currency inflation, but not otherwise.

From the preceding quotations the implication of the report is clearly to the effect that under the disorganized conditions prevailing since the war a

¹ Italics ours.

balanced budget and stable currency have been out of the question. During none of the years since the war have the essential conditions laid down on page 17 as a necessary basis for reparation payments been realized. And yet during these years, the German government has been confronted not only with pressing domestic financial requirements, and in addition has been required to finance reparation deliveries, restitutions, and clearing-house operations, as well as costs of armies of occupation and of various commissions of control and supervision. The Committee make one definite statement bearing on the question.

The Committee have noted the important fact that Germany is not in a position to ascertain her liabilities out of the Peace Treaty, as demands are made upon her from time to time during the year, which can not be calculated beforehand. It appears to us a matter of impossibility for any budget to be scientifically compiled under such an arrangement, and that therefore means should be found to bring this system to an end. (Part I, No. XI.)

The system thus denounced is the system which has been in vogue since the end of the war. Germany was confronted with the alternative of early admitting default or selling paper marks and thereby postponing the evil day. She had neither a balanced budget nor a balance in her international trade and financial accounts (without selling marks to foreigners), both of which the Committee hold to be necessary for the maintenance of currency stability.

V. CONTRIBUTIONS FROM SPECIAL SOURCES

The special sources to be utilized for securing reparation funds are the transport tax and railway and industrial securities. Taken together these sources are to yield ultimately one-half the entire sums to be collected.

The transport tax is to be devoted exclusively to reparation purposes. This tax was first imposed as a war measure, and has since been continued by the German government as a special source of revenue. It is paid by railroad shippers and passengers and amounts to about 6 per cent of the total gross receipts of the roads. The yield in 1924 is estimated at 227 million gold marks. The diversion of the transport tax, it will be observed, represents a definite reduction from the revenue that the German government would otherwise receive.

German railroad bonds are to be an important source of reparation money. The German railroads are to be divorced from government control and operated as a joint stock company under German management. The Committee believe that under private management the German railroads can be made to yield a substantial revenue in place of the present large deficit. They state that:—

Under proper management, under unified control, and with a proper tariff policy, the railways can without difficulty earn a fair return on their present capital value. (Part I, No. IX (B).)

The new railroad company is to be capitalized for 26 billion gold marks—the estimated actual cost of the German railroads computed on a gold-mark basis. Of this, 11 billions is to be represented by first mortgage bonds, 2 billions by preferred stock, and 13 billions by common stock. The first mortgage bonds, bearing 5 per cent interest and 1 per cent sinking fund per annum, are to be turned over to a trustee appointed by the Reparation Commission.

Of the preferred stock of 2 billions, one-fourth (500 millions) is to be the property of the German government, and three-fourths (1,500 millions) the property of the company. These shares are to be sold under such conditions that within two years the German government will be able to dispose of the whole 500 millions allotted to it. In the second year, 250 million gold marks derived by the government from the sale of these shares are to go for reparation purposes, the remaining 250 millions being a compensation to the German government for the loss of the transport tax. The common shares are to be owned by the German government and to be kept or sold as the government prefers.

The justification of seizing the first mortgage bonds of the railroads for reparation purposes is explained on the ground that the fall of the mark has practically wiped out the present railway debt and that it is only fair that the railroads should assume a mortgage debt for the benefit of the Allies.

Industrial properties are also to be mortgaged for reparation purposes. In addition to the railroad bonds, 5 billion gold marks of first mortgage indus-

trial bonds are to be turned over to a Trustee acting for the Reparation Commission. The interest on these bonds is to be 5 per cent, with sinking fund at 1 per cent. These payments are waived entirely the first year, and in the second year the rate will be only $2\frac{1}{2}$ per cent. Agriculture is not included among the industries to be mortgaged, on the principle that agriculture is of extraordinary importance to a nation unable to provide its entire food supply.

The justification for exacting special contributions from industry is that the industries of the country have greatly benefited as a result of currency depreciation. The Committee point out that mortgage indebtedness—

. . . has for the most part been discharged by nominal payments in depreciated currency or practically extinguished. In addition, the industrial concerns have profited in many ways through the depreciated currency, such as the long-delayed payment of taxes, by subsidies granted and advances made by the German Government, and by depreciation of the emergency money which they have issued. (Part I, No. IX (C).)

The Committee go on to point out, however, that the industries have also had their troubles. They state that—

It is incontestably true that there have also in many instances resulted losses, through the depreciation of the currency, from the sale of output at fixed prices and in other ways. It is unnecessary for the Committee to make an estimate of the total amount of such profit and losses; it is sufficient to say that the Committee is satisfied that a burden of mortgage debt of the amount of 5 billion

gold marks on the industries of Germany, fairly apportioned, bearing a moderate rate of interest and payable on long maturity, does not create a burden greater than that which would have existed had there been no depreciation of currency. (Part I, No. IX (C).)

The railway and industrial bonds may be offered for sale in foreign markets. The Committee point out that the annual reparation payments may be greatly increased by the sale of capital assets in the form of the mortgage bonds delivered to the trustee acting for the Reparation Commission.

As soon as the plan is put into execution, the Reparation Commission will be in possession of bonds for 16 billion marks, which may be sold to the extent to which the financial markets are capable of absorbing them. Subsequently, bonds representing the transport tax and the contribution from the budget may be issued, and will enable the government to realize the capital of their claim. (Part I, No. X.)

The question may therefore be raised, whether this appropriation of German securities for reparation purposes does not constitute a new method of making payments, namely, that of transferring *capital* directly to the creditors. There is, in fact, nothing new in this device, for the existing reparation bonds, delivered under the terms of the London Settlement, may also be sold in foreign markets. The fact that in the one case the bonds are obligations of the government, while in the other they are obligations of private citizens in no way changes the nature of the problem. In either case the actual making of

payments requires, as the Committee later point out, the shipping of goods by the German people across German borders.

But, it may be asked, are not mortgages on German industries better than the promises of a mere government? Is not a business obligation better than a political or government obligation? The Committee apparently do not hold this to be necessarily true, for it is provided that in case of the default in interest payments on either the railroad or industrial bonds they become the obligations of the German government. (Annex 4, No. IV, and Annex 5, No. III.)

VI. THE FOREIGN LOAN

The Committee recognize that Germany must have a partial moratorium on reparation payments, in so far as payments from her own resources are concerned. Four-fifths of the payments during the first year are to come from the proceeds of a foreign loan. The foreign loan is regarded by the Committee as an integral part of the entire scheme, being essential both to the stabilization of the currency and of business conditions within Germany, and to the financing of reparation payments during the preliminary period of economic rehabilitation.

The Committee's plan for the use of the proceeds of the foreign loan is ingenious. The sum of 800 million gold marks, to be derived from the foreign loan, is to be deposited, in the first instance, in the new bank

of issue, where it will constitute a necessary basis for sound currency. Now these funds could obviously not be used for financing deliveries in kind during the first year, if they were at the same time turned over to the Allies in meeting reparation obligations. Accordingly, the Committee provide that of the billion gold mark payments to be made during the first year, at least 800 millions must be spent in Germany.

In the interest of currency stability and to aid the successful inauguration of the new bank, the proceeds of the new loan should be used exclusively for financing . . . deliveries in kind (whether direct or by the operation of the Reparation Recovery Act), and that part of the costs of the armies of occupation which represents expenditures in Germany by or on behalf of these armies. (Part I, No. XV.)

The Committee stipulate no special security or priority for the foreign loan. They content themselves with saying that the loan should be fully secured, but that it should not "create a situation which would prejudice the flotation of subsequent German loans or the realization of the capital assets (that is, the sale of railroad and industrial bonds) provided for by the plan." They add that "it is not for us to offer suggestions as to the priority of claims or how the sums should be distributed." This loan is thus merely placed on a parity with reparation obligations.

It is important to note, however, that the Committee stipulate that the interest and sinking fund charges on this or any subsequent loans are included

within the total schedule of payments provided for Germany. The loan payments "must be deducted from the sums which in subsequent years can, in accordance with our plan, be placed at the disposal of Germany's creditors." (Part I, No. XV.)

Bank stock is also to be offered for sale in foreign markets. In addition to the foreign loan of 800 millions, it is evidently expected that a portion of the capital of the bank will be subscribed by foreigners. The capital of the bank is to be 400 million gold marks, of which 1 million shares (100 million gold marks) are to represent the assets of the Reichsbank, and 3 million shares (300 million gold marks) are to be offered for subscription in Germany and abroad. Whether sold in Germany or abroad, the shares are to be paid for entirely in gold or foreign bills of exchange at their gold values. (Annex 1, No. II.)

VII. SCHEDULE OF SUMS TO BE RAISED WITHIN GERMANY

This section is headed "Schedule of Sums to be Raised *within Germany*," for the reason that the Committee, as we shall presently see, makes a sharp distinction between the problem of collecting internal revenues and the problem of transferring these revenues to the foreign creditors. They advance no schedule of payments, so far as the external transfer side of the problem is concerned. There is presented below, in tabular form, the schedule of collections stipulated in the plan, indicating the sources from which the revenues are to be derived.

SCHEDULE OF SUMS TO BE RAISED WITHIN GERMANY

(In millions of gold marks)

Year	Budget	Transport tax	Railroad securities	Industrial bonds	Total
Budget moratorium period: 1924-25	None	None	200 (out of 330, interest on 11 billions of bonds)	None	1,000 (including 800 from external loan)
1925-26	None	250	130 (balance of the 330 for the first year) 465 (interest on bonds) 250 (sale by the government of preferred stock)	125 (interest)	1,220
Transition period: 1926-27	110	290	550 (interest on bonds)	250 (interest)	1,200
1927-28	500	290	660 (interest and sinking fund on bonds)	300 (interest and sinking fund)	1,750
Standard Year 1928-29 and thereafter	1,250	290	660 (interest and sinking fund on bonds)	300 (interest and sinking fund)	2,500

This general schedule of collections is subject to some slight modifications. The Committee recognize the probability of annual fluctuations in revenues and also the possibility that the general recovery of business prosperity may develop at a slower or faster rate, or to a greater or lesser degree, than was anticipated in drawing up the schedule.

During the transition period, some variation in the budget contribution is allowed. The plan provides

that the contributions to be derived from the budget in the third and fourth years may be either increased or decreased, depending upon the yield of the controlled revenues (taxes on customs, alcohol, tobacco, beer, and sugar). If the aggregate of these revenues exceeds 1 billion in 1926-27, or 1,250 millions in 1927-28, an addition shall be made to these contributions equal to one-third of such excess; if the aggregate falls short of these amounts, the budget contribution is to be diminished by one-third of the deficiency. Such additions or subtractions are limited, however, to an amount not exceeding 250 million gold marks each year.

The annual payments are to be varied in accordance with fluctuations in the purchasing power of gold. The Treaty prescribes Germany's obligations in terms of gold and the Committee's estimates are expressed in the same terms. But since over a long period of years gold may be an uncertain and defective measure, the Committee propose that the schedule of payments should be changed automatically "in correspondence with changes in the general purchasing power of gold, whenever, by the decision of an impartial authority, such changes amount to more than 10 per cent." (Part I, No. VIII (C).)

The total payments after 1929 may be varied in accordance with an "index of prosperity." During the five years 1929-30 to 1933-34 this index is to be applied only to the budget contributions; after 1933-34 it is to be applied to the total contributions. The prosperity index is computed on the basis of the following statistics:

(a) The total of German imports and exports taken together;

(b) the total of budget receipts and expenditures taken together, including those of the States of Prussia, Saxony and Bavaria (after deducting from both sides the amount of the Peace Treaty payments included in the year);

(c) railroad traffic as measured by the statistics of the weight carried;

(d) the total money value of the consumption of sugar, tobacco, beer and alcohol, within Germany (measured by the prices actually paid by the consumer);

(e) total population of Germany (computed from the last available census data, vital statistics and emigration records);

(f) the consumption of coal (and lignite reduced to coal equivalent) per capita. (Annex 2.)

The index computed from these data is to be used only in determining the increases that shall be demanded above the payments set forth in the general schedule worked out by the Committee. While no provision is made for decreasing the payments, it is provided that in case the index shows a minus quantity, an allowance for this fact must be made in subsequent years before any further increase in payments is required.

The schedule of payments laid down is all inclusive. In place of the miscellaneous, not to say heterogeneous, series of obligations for which Germany is liable under the Treaty of Versailles, the Committee of Experts fix what amounts to a single obligation.¹

¹ Two minor and perhaps unintended exceptions to this provision are to be found in the report. Article III of the Railway Plan (Annex 4) says that "The expenses of the Railway Commissioner and his staff shall be an operating charge upon the receipts of the

We desire to make it quite clear that the sums denoted above . . . comprise all amounts for which Germany may be liable to the Allied and Associated Powers for the costs arising out of the war, including reparation, restitution, all costs of all armies of occupation, clearing-house operations, . . . commissions of control and supervision, etc. . . . They include also special payments such as those due under Articles 58, 124 and 125 of the Treaty of Versailles. . . . We venture to emphasize the fact that from the point of view from which we are called upon to regard the question, these obligations of Germany are one, and that any addition to one category of charges can only be made at the expense of another. (Part I, No. XI.)

The Committee, however, take no stand as to questions of priority between the various categories of charges.¹

railways." Article IX of the same Annex contains the same provision with regard to the expenses of the Organization Committee and their staff.

¹ Attention may not improperly be directed to the fact that it is from this one fund, accumulated to the credit of and administered by the Transfer Committee, that must come whatever payments are to be received by citizens or by the government of the United States from the German government. These payments fall into two broad classes: first, the awards to United States nationals by the American-German Claims Commission now sitting in Washington, and secondly, the reimbursement of the cost of military occupation by the troops of the United States in the Rhineland, 1919-1922. An agreement signed at Paris, May 25, 1923, between representatives of the United States, England, France, Italy and Belgium fixed this reimbursable sum at 1,071,000,000 gold marks. This agreement, not yet ratified by the French National Parliament, provides for payments (with priority) to this country in twelve annual instalments. The United States government, however, took care to file a claim for this amount with the American German Claims Commission, lest no proceeds ever come to it from the agreement with the Reparation Commission. The aggregate

Deliveries in kind are properly held to be identical in effect with cash payments. It is clearly recognized by the Committee that it is impossible to go on making deliveries in kind without regard to financial and international trade considerations.

We have given special attention to the question of deliveries in kind: in their financial effects deliveries in kind are not really distinguishable from cash payments; and they can not in the long run exceed the true surplus of German production over consumption available for export without either upsetting the exchange or rendering foreign loans necessary. (Part I, No. XI.)

This same view is in marked contrast to the practically universal assumption hitherto underlying all public discussions of this question, namely, that no financial or exchange problems are involved in making deliveries in kind—that all that is necessary is to produce the commodities in question and deliver them. The truth of the matter, of course, is that Germany's default in deliveries in kind was attributable to the fact that she was able to finance them only by disastrous inflationary means because she possessed no export surplus.

awards (against which the government is still holding the property of German nationals seized during the war) of the latter body can not yet be estimated. Conceivably, however, as a grand total of all accounts, from three-quarters of a billion to a billion dollars will have to be paid to our government or citizens. The instalments necessary to liquidate this amount will come through the Transfer Committee, unless the European signatories to the Treaty of Versailles insist that an agency set up to handle payments under that Treaty shall have nothing to do with payments provided for under the Treaty of Berlin of August 25, 1921, between the United States and Germany.

While recognizing that in the last analysis deliveries in kind are not different in character from other payments, the Committee, nevertheless, point out the importance of continuing the commodity deliveries directly to the Allies. They emphasize, however, that—

Unless they can be confined to natural products of Germany, such as those specifically dealt with in the Treaty (coal, coke, dyestuffs, etc.), and in the second place to exports which do not entail the previous importation into Germany of a large percentage of their value, they tend to be uneconomic in character. (Part I, No. XI.)

An interesting and commendable provision in this connection reads as follows:

The goods supplied by Germany to the creditor countries . . . shall be for the sole use of the countries receiving them and for their internal requirements, including the requirements of their colonies and dependencies. The goods so delivered shall not be exported from the country receiving them, except by agreement between the [Transfer] Committee, acting unanimously, and the German government. (Annex 6, No. V.)

VIII. THE PROBLEM OF TRANSFERRING PAYMENTS TO THE CREDITORS

We find for the first time in any official discussion of the reparation question a clear recognition of the twofold nature of the problem, namely, the collection of funds within Germany and the transfer of wealth in acceptable form to the Allies. Heretofore, spokesmen for the Reparation Commission and for Allied

governments have merely insisted that the German government should tax its citizens and deliver the money for the benefit of Allied treasuries. The means by which the payments were to be effected was said to be Germany's problem and no concern of the Allies.

There has been a tendency in the past to confuse two distinct though related questions, i.e., first, the amount of revenue which Germany can raise available for reparation account, and, second, the amount which can be transferred to foreign countries. The funds raised and transferred to the Allies on reparation account can not, in the long run, exceed the sums which the balance of payments makes it possible to transfer, without currency and budget instability ensuing. But it is quite obvious that the amount of budget surplus which can be raised by taxation is not limited by the entirely distinct question of the conditions of external transfer. We propose to distinguish sharply between the two problems. . . . In the past, the varying conclusions formed as to Germany's "capacity" have often depended upon which of these two methods has been chosen. (Part I, No. VIII (d).)

To the lay reader it may be explained that "balance of payments"—or "economic balance," which the Committee also use—is a technical term which broadens the meaning of "balance of trade" to include the non-trading operations between nations, such as shipping, banking, insurance services, interest payments, tourist expenditures, etc. Germany would have a favorable balance with which to meet reparation obligations, provided her receipts from the export of goods, the rendering of services, etc., exceeded her expenditures for necessary imports,

services, etc. This favorable economic balance, or balance of payments, is also commonly referred to as the export surplus.

It may also be explained that the process of making payments is as follows. The funds collected within Germany are in the form of German paper currency. This currency is not, however, acceptable to the creditors; German money must somehow be exchanged for foreign money. Now if German business men export goods or render services to foreigners, they are entitled to payments in foreign currency—or bills of exchange. Accordingly the German government, or rather the Agent for Reparation Payments, to whom the German money has been delivered, may trade the German money to the exporters for their foreign bills and then deliver the latter to the creditor governments. It will be readily seen, however, that not all of such export bills can be thus used, since this would make it impossible for German importers to procure foreign money with which to pay for goods purchased abroad. A sufficient volume of bills of exchange must be left in the market to permit the financing of essential imports, or the whole German economic system will collapse.¹

¹ As a technical matter it would also be possible for the Agent for Reparation Payments to draw bills (write checks, so to speak) against the balances accumulated in the reparation bank and offer these bills for sale in foreign money markets. The buyers there would be importers of German goods, and they would buy these mark bills as a means of making payments in Germany. The number of such bills that could be sold would of course depend upon the volume of German exports to be paid for. Hence, this process is essentially the same as the other. German exports are the means by which foreign money is obtained.

It is for this reason that the making of payments depends upon a surplus of exports, or, to speak more inclusively, a surplus of exports and services. At bottom it is clear that the transfer of tangible wealth constitutes the only means of payment. Money or bills of exchange are mere instrumentalities in the process.

The Committee set up no schedule covering the transfer of funds to the Allies. They venture no prediction as to the favorable balance of payments or export surplus that can be expected, given a recovery of German prosperity. Rather, they state:

A country's "economic balance" defies exact calculation. . . . It depends not on the decisions of a single [governmental] authority, but on the enterprise of individual merchants and manufacturers. Reparation demands themselves will increase it. The extent to which economic adaptation is possible over a long period of years, under the pressure of external obligations, is a matter of conjecture; an existing economic balance, before such obligations have been in operation long enough to have their effect on the economy of the country, gives a very uncertain criterion. The economic balance is, therefore, by comparison with the budget incapable of close calculation, "unmanageable" and too elastic. But the limits set by the economic balance, if impossible of exact determination, are real. (Part I, No. VIII (d).)

The Committee have accordingly set up a very ingenious device for regulating the amount of payments to be made annually by means of whatever export surplus may develop. The sums collected within the country are to be paid into the bank of issue to the credit of the Agent for Reparation

Payments. This payment constitutes the definitive act of the German government and the German railroads and industries in meeting their financial obligations under the plan. The transfer of the funds thus deposited will be controlled by a specially constituted Transfer Committee. This committee will endeavor to regulate the payments in such a manner as to prevent difficulties arising with the foreign exchange and without bringing about instability of currency. The following provision is of paramount importance:

If the payments by Germany on reparation account, in the long run, exceed the sums that can be thus transferred by deliveries or by purchase of foreign currencies, they will of course begin to accumulate in the Bank. Up to a certain point, in normal circumstances not exceeding 2 billion [marks], these accumulations will form part of the short-money operations of the Bank. Beyond this point, the Committee will find employment for such funds in bonds or loans in Germany under the conditions laid down in the Annex; but, for economic and political reasons, an unlimited accumulation in this form is not contemplated. We recommend that a limit of 5 billions be placed upon all funds accumulating in the hands of the reparation creditors in Germany. If this limit is reached, the contributions from the budget are to be reduced below the standards set out in our plan, so that they are not in excess of the withdrawals from the account and the accumulation is not further increased. In this contingency, the payments by Germany out of the budget and the transport tax would be reduced until such time as the transfers to the Allies can be increased and the accumulation be reduced below the limit named.¹ (Part I, No. XIII.)

¹ It is of interest to note that this ingenious device is also found in the plan for Hungarian financial reconstruction, worked out by

The amount of the export surplus is made the final measure of Germany's capacity to pay. The exchange and foreign trade side of the problem is placed in a position of controlling importance. As a year-to-year proposition—once the 5 billions have been accumulated within the country—the amount that is to be raised within Germany is to be limited by the amount that can be transferred to the creditors by means of an export surplus. The amount of payments that can be expected out of an export surplus, however, is wholly unpredictable.

While the provision calls for a maximum accumulation in the bank and in the form of investments of 5 billion gold marks, it is provided that "the Transfer Committee shall have power to suspend accumulation before reaching 5 billion gold marks, if two-thirds of its members are of the opinion that such accumulation is a menace to the fiscal or economic situation in

the Financial Committee of the League of Nations, under the chairmanship of M. Albert E. Janssen who later was a member of the Second or McKenna Committee of Experts. The Hungarian plan, which was submitted to the Council on December 20, 1923, makes the following provision for the regulation of the transfer problem:

"It is also necessary, in order to avoid a danger of the value of the crown being depreciated, that any Treaty charge payments made by Hungary should be paid in Hungarian crowns into an account in the name of the Reparation Commission at the Bank of Hungary; and that it should be the duty of the Chairman of the Bank to convert these sums into foreign currencies at the earliest moment, but at such times and in such a manner as to prevent them depreciating the value of the crown. If it is considered that the Chairman is not proceeding with this transfer with the requisite promptitude and regularity, we think it would be proper to contemplate a request to the League of Nations to appoint an arbitrator whose decision should be final." (Section X, Paragraph 2 f.)

Germany or to the interests of the creditor countries." On the other hand, the Committee may suspend the 5 billion limit, and allow the accumulation of funds beyond that sum "in the event of concerted financial manœuvres either by the German government or any other group for the purpose of preventing such transfers."

It is interesting to learn the Committee's reasons for not beginning their analysis with the foreign trade and exchange side of the problem and stating at the outset that the amount that Germany can pay will depend upon an unpredictable export surplus instead of fixing certain definite sums to be raised within the country. Referring to the transfer problem, they say:

We do not deny that this part of our proposal will present difficulties of a novel character which can only be solved by experience. But what are the alternatives?

In order that no difficulties with exchange or stability can possibly arise, the sum payable for reparation may be definitely fixed at such a figure as is certain beyond all doubt to be within Germany's capacity to export in excess of her imports. In this case the attainment of such certainty *would involve so low a figure as to be quite unacceptable to her creditors and unwarrantably favorable to Germany.*¹

On the other hand the liability may be fixed without regard to that excess of exports at all, and the discharge of the liability left to uncontrolled events without any possible regard to exchange difficulties. That way lies future instability and disaster.

We are convinced that some kind of coordinated policy with continuous expert administration in regard to the exchange, lies at the root of the reparation problem and

¹ Italics ours.

is essential to any practicable scheme for obtaining the maximum sums from Germany for the benefit of the Allies." (Part I, No. XIII.)

It is clear from these statements that the Committee deemed it expedient to fix the schedule of payments much in excess of the amounts which there was reason to believe could be transferred by means of an export surplus. Once the report is accepted and the plan put into operation, they will rely upon the expert administration of the exchanges to make the actual payments conform with the economic realities of the situation. The importance of this provision for controlling the exchanges will be discussed in Chapter V.

CHAPTER II

ADMINISTRATIVE AND CONTROL FEATURES OF THE PLAN

To put the new reparation plan into successful operation requires the setting up of certain economic agencies for its administration. It is of course also necessary to establish control devices for safeguarding the interests of the Allies and making sure that Germany will attempt in good faith to meet her obligations. In setting up these agencies and devices the Committee of Experts have been concerned with four main problems: (1) stabilizing the currency; (2) collecting funds within Germany; (3) transferring these funds to the Allies; and (4) co-ordinating the work of the various agencies with that of the Reparation Commission.

I. STABILIZING THE CURRENCY

A fundamental necessity for the successful operation of the plan, as shown in Chapter I, is the establishment and maintenance of a stable currency. In addition to a balanced budget and a balanced international trade, for effecting such a stabilization a primary requirement is the creation of a new bank with adequate gold reserves.

The New Gold Bank

The new bank of issue, which is to be chartered for a period of fifty years with an initial capital of 400 million gold marks, is to supersede the existing Reichsbank. The purpose and principal features of the bank are indicated by the following provisions.

(1) The bank is to have virtually an exclusive right to issue paper money in Germany. No governmental agency, either national, state, or local, nor any private corporation or individual is permitted to issue paper money—with the exception of the banks of Baden, Saxony, Bavaria, and Wurtemberg, whose issues are restricted to their present legal quota.

(2) The miscellaneous types of currency now in circulation are to be gradually retired. The outstanding Reichsbank notes are to be redeemed and cancelled at the current rate of exchange, that is, at one trillion paper marks to one gold mark. The notes of the Rentenbank are to be gradually withdrawn from circulation during a period of ten years. No provision is made for redemption at any given rate of exchange of the vast quantities of emergency paper currency issued by states, cities, corporations, etc.

(3) The legal reserve back of the currency of the new bank notes is to be nominally $33\frac{1}{3}$ per cent, although under special circumstances this reserve ratio may be cut under—with tax penalties similar to those provided in the Federal Reserve System of the United States. The reserve may be in the form

of gold balances or gold coin and held at any office of the bank or in the form of deposits in foreign banks payable in gold or its equivalent. A reserve in gold of only 12 per cent—with tax penalties for under-cutting—is required against deposit liabilities. In addition, it is provided that the bank shall hold an additional 30 per cent in the form of very liquid assets—demand deposits in Germany and abroad, checks on other banks, and commercial bills payable at call or within thirty days.

(4) The notes of the new bank are not to be immediately redeemable in gold, although it is hoped that the period of inconvertible money will prove of short duration.

(5) The bank will perform all the ordinary functions of a central bank, such as maintaining an official rate of discount, rediscounting bank paper, dealing in open-market transactions, acting as fiscal agent of the government, etc.

(6) A primary function of the bank will be to act as depositary for the reparation funds. These funds will be deposited in the name of the "Agent for Reparation Payments."

The bank is to be organized by a temporary "Organization Committee," consisting of the President of the Reichsbank and one person who shall have been a member of the (present) Committee of Experts. This committee shall have the responsibility of bringing the bank into existence, of interpreting any ambiguities appearing in the plan, and of framing the statutes regulating the administration of the bank.

The interests of the Allies in connection with the bank are to be safeguarded through representation in the management. The bank is to be administered by an all-German Managing Board and by a General Board of which seven members are Germans and the other seven foreigners; representing respectively Great Britain, France, Italy, Belgium, Holland, Switzerland, and the United States.

In brief, the Managing Board is vested with the routine conduct of the bank's operations, and the General Board "is given broad powers in such matters of bank organization and operation as might affect the interests of the creditor countries." The responsible administrative officer of the bank, referred to in the report as the President, is to be Chairman both of the General and the Managing boards. The present President of the Reichsbank is designated as the first incumbent of this office. Subsequent chairmen are to be chosen by the General Board either from among the German members of the General Board or from outside the board, and the appointment is to be countersigned by the President of the Reich.

The General Board, on which the Allies are represented, is, through certain provisions in the plan, given virtual control over the bank. (1) It has the power of choosing the President of the bank, the President in turn appointing the Managing Board, subject to the approval of the General Board. (2) It is given authority to fix the salary and pensions of the President and of the Managing Board. (3) One of the foreign members of the General Board,

with the title of Commissioner, is particularly entrusted with the duty of enforcing the legal provisions relative to the issue of notes and the maintenance of the bank's reserves. An important provision is that this Commissioner may also attend the meetings of the Managing Board.

The provisions as to appointment and voting are, of course, of prime significance. The first German members of the General Board are to be chosen according to a plan to be worked out by the Organization Committee. Subsequently the German members will be chosen by the German stockholders in the bank. The first foreign members of the General Board are to be chosen by the Organization Committee, with advice from financial authorities in the countries represented. Subsequently, vacancies are to be filled by the vote of the foreign members of the board.

In the election of the President the German members of the General Board are given the deciding vote. The plan stipulates that the President—who must himself be a German—is to be appointed by a majority of nine votes, of which at least six shall be the votes of the German members. In the election of the Commissioner, on the other hand, the foreign members are given the deciding vote. A majority of nine is again required; but in this case at least six of the nine votes must be cast by foreign members. In other matters not especially provided for in the bank's statutes, decisions of the General Board are to be by a majority vote of ten members, or by a simple majority vote, if the President and

Commissioner are included in the majority. The requirement of ten votes out of fourteen makes it impossible for either German or foreign members to control the Board, and thus the interests of both Germany and the Allies are safeguarded. The same result is secured by a simple majority where the President and foreign Commissioner are both included.

The new bank's policy can not be dominated by the German government. It will be apparent from the above provisions that the new gold bank, unlike the Reichsbank, is independent of German government control. The statutes of the bank must, however, be submitted to the German Parliament for approval. The bank is also practically barred from financial relations with the government. Subject to the exception in the following paragraph, "the bank shall make no loans, discounts, or other advances, directly or indirectly to the German Reich, any German state, communes, or other governmental units. . . . The deposit accounts and current accounts of these various governmental units shall never show a debit balance."

Small temporary advances or short-time loans may be made by the Managing Board to the Reich. The amount outstanding at any time must not, however, exceed 100 million marks, and the Reich must never be indebted to the bank at the end of the financial year.

II. COLLECTING FUNDS WITHIN GERMANY

It is in connection with the collection of revenues within Germany that the question of "productive guarantees" naturally arises. Has the Committee established control devices which will make it certain that the sums stipulated will be collected? In the event of a failure on the part of Germany to fulfil her obligations, have they protected Allied interests by productive guarantees or sanctions? These questions arise in connection both with the ordinary budget revenues and with the special revenues provided for under the plan.

The administration of the ordinary budget and of the controlled revenues may be very briefly disposed of. We have already pointed out that the Allies are not to exercise, in the ordinary course of events, any general control over the administration of the German budget. Only in the extreme event of Germany's *wilful* failure to meet the obligations laid upon her is the safeguard of general budgetary control by the Allies provided. Under ordinary circumstances the Allies are to have a hand in the administration only of the controlled revenues.

The Controlled Revenues

As has been shown in the preceding chapter, the controlled revenues are to be paid directly into the reparation account. For the purpose of administration, a Commissioner of Controlled Revenues is to be appointed by the Reparation Commission,

together with a subcommissioner for each of the five controlled revenues—tobacco, alcohol, sugar, beer, and customs. The chief commissioner may be chosen either from Allied or neutral countries. It is recommended that he should be assisted also by an advisory and consultative committee, on which each of the interested Allies is to be represented.

In the ordinary course, the Commissioner's duty is to exercise only a general oversight of the controlled revenues and the industries from which they come, and to make periodical reports to the Reparation Commission. If the revenues should be in danger of becoming insufficient it would then be his duty to take every possible measure to increase their productivity. By what precise means this would be done is not, however, made clear.

No effective guarantee is provided in connection with budget contributions. As was noted in Chapter I, any excess of controlled revenues over the reparation requirements is to be turned back to the German treasury. It was also noted in Chapter I that minimum German domestic expenditures must be provided for, or the currency would become disorganized and the whole plan would break down. This means that if the tax revenues—with honest administration—should prove insufficient to meet the minimum domestic requirements, these controlled revenues would have to be paid into the treasury instead of into the reparation account. There is thus no guarantee that the budget contributions will be forthcoming.

The Railroad Bonds

With a view to securing a surplus of earnings for reparation purposes, the German railroads are to be turned over to a joint stock company, controlled jointly by Germany and the Allied countries. The work of initiating the plan, organizing the company, and working out the administrative details, is delegated to an Organization Committee composed of five members, two representing Germany, two the Allies, and one a neutral country.

The company will be administered by a Board of Directors of at least eighteen members. Nine of these will, at the start, be appointed by the German government; but as soon as the preferred stock has been sold the holders thereof shall be entitled to elect four directors to replace four of those appointed by the German government. The Trustee for the bondholders (see following paragraph) will appoint the other nine members of the board, of whom five may be German citizens. The Chairman of the Board will be elected by a three-fourths majority vote of the Board, from among the four directors representing the interests of the preferred stockholders. The General Manager of the company is not eligible to a seat on the Board. He must be of German nationality and is appointed by, and may be removed by, a three-fourths vote of the Board. Thus far, it will be seen that the control of the company is largely in German hands.

Allied interests are protected through the powers vested in a Trustee for the bondholders and in a Rail-

way Commissioner. The primary interest of the Allies, of course, centers around the 11 billions of bonds which are to be used for reparation purposes. These bonds are in charge of a Trustee acting for the bondholders, appointed by the Reparation Commission and accountable to it.

The Railway Commissioner, who is not a member of the Board of Directors, is appointed by a majority vote of the foreign members of the board. He is granted broad powers of supervision. He shall have a general right of inspection over the whole railway system, shall be entitled to receive all statistical and financial reports, proposals for tariff changes, etc., and he may call for any special reports which he may consider necessary in order for him to form an independent opinion. Any objections which he may have are first laid before the General Manager. If the latter can not be persuaded to change his line of conduct, the Commissioner lays the question before the Board of Directors in order that it may take any measures deemed necessary.

In the event that the German railways fail to yield the net revenue fixed as reasonable for reparation purposes, the Commissioner is given very broad powers of control.

We assume that, broadly speaking, in this case the Commissioner will take over the functions of the General Manager, and, in lieu of discussing with the General Manager or recommending to the Board of Directors, he would be empowered to issue positive orders, whether for stopping expenditure which he considered unjustifiable or for an increase which he considered reasonable in existing

tariffs. It is evident that it would be necessary to require the German government to agree in advance that, if payment on the agreed scale failed to be reached or even if there was serious danger that this failure would occur in the immediate future, the Commissioner, as the representative of the Allies, should be entitled to enter into full control. (Annex III.)¹

This provision obviously places in the hands of the Railroad Commissioner a very complete control over all German economic activity. By changing the railroad rates he may not be able to increase the revenues, but he can profoundly influence German economic activities. If the failure to raise the revenues prescribed is due to chicanery on the part of the Germans, the control by the Commissioner might be effective in producing increased revenues. If, however, the railroads are getting all the traffic will bear, such control would, of course, not be effective. This provision has naturally evoked much protest on the part of the Germans.

There is another important railway control provision, concerned with the problem of default in interest payments on railroad bonds.

If in any year the German railways fail to realize receipts sufficient to allow the payments on the bonds (it being understood that the company may draw upon whatever reserves may be available for this purpose until such reserves are exhausted), the Railway Commissioner shall have the right to take such action as the trustee for the bondholders may consider is necessary to protect the rights of the bondholders, including the right

¹ Quoted from the special report of the technical railway experts, W. M. Acworth and G. Leverve.

to operate, to lease, or to sell all or any of the railways and property subject to the mortgage or change of the bonds. (Annex No. 4, Article IV.)

This provision does not, however, provide any real guarantee of payments. There is no reason to believe that the railroads could either be operated by the Allies or leased in such a way as to yield larger returns than under the plan provided. And if the railroad property were sold "subject to the mortgage or charge of the bonds," the new company would then have the problem of making the payments. Why should such a company be any more successful?

Interest on railroad bonds may be paid out of controlled budget revenues, but it is not guaranteed. In case the railroads are not able to pay interest on the bonds, it is provided that the surplus of controlled revenues shall be used for the purpose. That is to say, if the sums derived from the controlled sources of taxation exceed the amount which the plan stipulates must be paid into the reparation account from such sources, the remainder shall be devoted, in case of necessity, to payment of interest on the railroad (and industrial) bonds. We have, however, already noted the possibility of a deficiency rather than a surplus of revenue from these sources, in which event the German government's own fiscal requirements would have to be given a prior claim over reparation payments (pp. 13-15). It will be seen, therefore, that no effective guarantee has been provided.

Controversies over railroad problems shall be arbi-

trated. Disputes between the Reparation Commission or an Allied government and the railroad company, between the Reparation Commission or an Allied government and the German government, and between the railroad company and the German government, shall be referred to an arbitrator. If the German government desires it, this arbitrator shall be a neutral nominated by the President of the Permanent Court of International Justice. The arbitrator's decision shall be final.

The only other place in the plan where arbitration is provided is in connection with the gold-purchasing-power index. If the German government and the Reparation Commission shall fail to come to an agreement with reference to altering the schedule of payments in accordance with the changed purchasing power of gold, a decision shall be given by an arbitral committee appointed by the League of Nations. (Annex 2.)

The Industrial Bonds

The five billions of first-mortgage industrial bonds which are to be used for reparation purposes are to be the individual obligations of particular industrial, navigation, mining, and similar German concerns. They are to be in charge of the same Trustee who acts for the railroad bondholders. The plan also provides that if need arises, a Commissioner of Industrial Debentures may be appointed. The preliminary work of putting this part of the plan into operation is placed in the hands of a temporary

organization committee composed of two German, two Allied, and one neutral representative.

The interest on the industrial bonds is not guaranteed. In case of default on the part of industrial concerns, these bonds, like the railroad bonds, become the obligation of the government. But, as in the case of railway securities and of the controlled revenues, circumstances may well arise where the interest can not be met without producing a budgetary deficit and disorganizing the currency. In other words, the plan recognizes that a quart can not be extracted if there is only a pint in the reservoir.

In general, reliance is placed upon good will and economic possibilities rather than on penalties or sanctions. The Committee's recommendations are at bottom based on the belief that the best guarantee lies in the establishment of a just and workable plan and in the good faith of all concerned. Political guarantees and penalties to ensure the execution of the plan fall outside the Committee's jurisdiction as do also questions of military occupation. All the Committee's estimates, however, as previously noted, are based on the assumption that economic activity will be unhampered and unaffected by any foreign organization other than the controls provided above. They nevertheless point out that in case of flagrant failure to fulfil the conditions—

It is plainly for the creditor governments, acting with the consciousness of joint trusteeship for the financial interests of themselves and of others who will have advanced money upon the lines of the plan, *then* to determine the nature of sanctions to be applied and the

method of their rapid and effective application. (Part I, No. III.)¹

In accordance with the spirit of the Committee's plan, military or other penalties could justly be imposed only in case it were clearly established that Germany had wilfully failed to meet her obligations. The mere fact of default would obviously not warrant military action. The Committee's insistence upon "a consciousness of a joint trusteeship" on the part of the creditors is also important, for it would prevent precipitate action on the part of any one creditor alone without reference to the interests of the other creditors or of the nations subscribing to the international loan.

III. TRANSFERRING THE FUNDS

The Committee emphasize the fact that the collection of reparation funds within Germany and the transfer of these funds to the Allies are distinct problems. Since the definitive act of the German government consists merely in paying funds into the reparation account, it will be seen that the transfer problem is of primary concern only to the Allies. For the purpose of effecting the conversion of German money into foreign money acceptable to the Allies, the Committee has provided only one agency, or control device—the Transfer Committee. This agency is recognized as the most important as well as the most ingenious part of the whole plan.

The Transfer Committee

The Transfer Committee is composed of five members—a Frenchman, an Englishman, an Italian, a

¹ Italics ours.

Belgian, and an American—each of whom will be appointed by the Reparation Commission, after the general board of the central bank of his own country has been consulted. In addition, there is a chairman, and sixth member of the committee, known as the Agent for Reparation Payments, who links up the work of this committee with that of the other agencies provided for in the plan. All payments for reparation purposes, from whatever source, are first turned into the central bank to the account of this agent.

As Chairman of the Transfer Committee, the Agent for Reparation Payments is also given authority to draw upon the reparation funds deposited to his account. This committee is instructed—

(a) To apply such bank balances for payments for deliveries in kind and payments under the Reparation Recovery Act, in accordance with the program established periodically by the Reparation Commission, after consultation with the Transfer Committee as to the character and amount of such deliveries;

(b) to convert these bank balances into foreign currencies from time to time and, after conversion, to remit them in accordance with the instructions of the Reparation Commission; . . .

(c) to invest from time to time in bonds or other loans in Germany, such amounts as the Committee may deem wise. (Annex 6, No. III.)

The principles governing the transfer of funds to the Allies were set forth in Chapter I. It may be recalled that the function of the Transfer Committee is to adjust the transfers in the light of foreign trade conditions and with a view to preventing a disor-

ganization of the exchanges. Accordingly, whenever there is no favorable balance of payments, the committee must allow the funds to accumulate on deposit in the bank up to a total of 2 billion marks; and thereafter, up to a total of 5 billions, they shall invest them in Germany. Subsequently, if a large foreign trade balance should develop and make possible payments in excess of current requirements, the Transfer Committee would liquidate such loans and investments and transfer the sums to the Allies. It may also be recalled that 5 billions will be the maximum accumulation allowed, and that accumulation may even be suspended before this limit is reached upon a two-thirds vote of the members of the committee.

IV. COORDINATING THE CONTROL

Obviously some provision is necessary for ensuring the coordination of the various control agencies and their proper functioning in relation to the Reparation Commission. This important function, in addition to that of acting as paymaster general, devolves upon the Agent for Reparation Payments. The Committee of Experts also suggest that the various commissioners, together with the Trustee for the bondholders and the Agent for Reparation Payments, should constitute a general coordinating board. This board would have advisory powers only. The details of this part of the plan are left to the Reparation Commission, and to the various governments concerned.

CHAPTER III

REPORT OF THE COMMITTEE ON GERMAN ASSETS ABROAD

The flight of German capital has been one of the most controversial issues connected with the reparation problem. It has been widely believed that Germany has accumulated vast quantities of money in foreign banks, that the export of such funds has been one of the principal causes of the disorganization of the German financial system, and that if these funds could be seized, they would go far toward meeting reparation obligations. The task assigned to the second, or McKenna, Committee was to ascertain the amount of German capital held abroad and to suggest means of bringing it back to Germany.

The investigation conducted by the second Committee, though of comparatively minor importance, is closely related to the problems with which the first Committee were concerned. In fact, the second report is of interest largely because of the light it throws on the findings of the first Committee, and on the possibility of making reparation payments under the plan proposed.

I. VALUE AND CHARACTER OF THE FOREIGN ASSETS

The second Committee reach the conclusion that "German capital abroad, of every kind, including

capital in varying degrees of liquidity and capital invested in the participations of foreign companies and firms, after taking account of all credit and debit items, was at the end of 1923 not less than 5.7 billion gold marks and not more than 7.8 billion gold marks, and we think that the middle figure of 6.75 billion gold marks is the approximate total." In addition they find that there is now within Germany foreign currency amounting to not less than 1.2 billion gold marks.

The figure of 6.75 billion gold marks does not represent bank balances alone. It covers all of Germany's holdings abroad whether in the form of bank balances, investments in securities, or ordinary property ownership. Moreover, this figure is to a considerable extent offset by the investments of foreigners in property within Germany. The Committee do not specifically state what part of the total foreign holdings are in the form of liquid bank balances. Since it is important, from the point of view of the first Committee's analysis, to know the amount of these liquid funds, we shall attempt not only to show how the Committee arrived at its total, but to indicate the extent to which these assets are in liquid form.

The Committee base their conclusions on a study of Germany's pre-war assets and her balance of payments during the war and post-war period. It had been naïvely assumed by many people that the investigation would be carried on through direct inquiries to bankers and business men in countries where German capital was believed to be deposited

or invested. The Committee state that they rejected this method at the outset, believing it would be "neither proper nor useful." The method which they did adopt was that of estimating the extent to which Germany's pre-war foreign holdings have been reduced as a result of the war and the peace.

Several steps were involved in this investigation. (1) They estimated the total value of German capital held abroad at the outbreak of the War, (2) subtracted from this sum the estimated amount of losses sustained "as a result of depreciation and liquidation and sequestration measures," plus the amount of securities sacrificed in paying for imports, (3) added the value of property in the ceded areas which is now owned by people living in Germany, (4) added the estimated surplus in the balance of payments which has been available for investment abroad since 1914. The Committee's analysis under each of these headings is briefly summarized below.

(1) The Committee accept a figure of 28 billion gold marks as the value of foreign assets in 1914 belonging to German nationals residing in Germany. It should be noted at this place that this figure represents *gross* investments, and that there is an offset of several billions of gold marks representing pre-war loans of foreigners to Germany. The Committee failed to call attention to this fact.

(2) With reference to the *total* reduction in the value of Germany's foreign investments during and since the War the Committee give no definite figure. For the war years, they estimate the losses due to "depreciation, liquidation, and sequestration" at

16.1 billions. This sum they characterize as "a net reduction in German assets abroad for which Germany, during the war period, received no return." In addition, they point out that other foreign investments were sacrificed during the War in payment for imports; but they venture no estimate as to the amount. Since the end of the War, the remaining assets have further depreciated in value. While they do not commit themselves to a definite figure as to the amounts still remaining, the Committee conclude that Germany's foreign investments at the end of 1923 represented only a small fraction of the pre-war holdings, and that not all of these are productive.

(3) No figures are given for the amount of the property in the ceded areas which is now owned by people living in Germany. The Committee content themselves with saying that—

German private property in the ceded territories of Silesia, Posen, Danzig, etc., are included in our estimate in so far as, according to the definition adopted by the committee, they are owned by Germans residing in Germany. Although it is very difficult to determine with any precision the extent of these properties the committee considered it could not exclude from its valuations certain industrial assets, particularly those in Upper Silesia.

(4) To estimate the surplus from the balance of payments required an investigation of a number of types of operations: export and import trade; sale of real estate, securities, and paper marks; fulfilment of treaty obligations, etc. They give separate estimates for the war and post-war periods.

For the war period, the trade deficit is set at 15.2 billion gold marks. They estimate that this deficit was met in part as follows: gold exports, 1 billion; sale of domestic securities, 1 billion; sale of paper marks and levies on the people in the occupied territories, 5.7 to 6 billions—a total of approximately 8 billion gold marks.

No attempt is made to show how the remaining deficit of about 7 billion gold marks was met. It might have been met by the sacrifice of foreign securities, or the excess imports might have been procured on credit. In either case, Germany's *net* income from foreign investments would have been thereby reduced. While the Committee make no mention of the fact, it is well known that during the war Germany did procure a considerable volume of her imports on short-time credit—which became a charge against the future.

For the post-war period, the Committee estimate that Germany has had a small surplus in her balance of payments. This surplus was made possible by the sale of paper marks and capital assets. So far as the ordinary items entering into the balance of payments are concerned, there was clearly a substantial deficit. During the years 1919–1923, Germany has had to meet certain cash obligations arising under the peace treaty, and, in addition, has had to pay for necessary imports. The Committee estimate that the proceeds from the export trade fell from 9 to 10 billion gold marks short of the sums actually disbursed in treaty payments and the sums required to

pay for imports.¹ This deficiency was covered as follows:

	Billions of gold marks
Sale of paper marks and mark credits.....	7.6 to 8.7
Sale of gold.....	1.5
Sale of domestic securities and real estate....	1.5
	10.6 to 11.7

It will be seen that the sale of paper currency to foreign speculators and the sacrifice of gold and capital assets provided sums sufficient to cover the export deficit, to make some cash reparation payments, and to leave a surplus of about 1.7 billion gold marks available for investment.

Other credit items in the post-war balance of payments specifically mentioned by the Committee are: expenditures of travelers and armies of occupation; income from shipping, insurance, and the transit trade; and remittances of emigrants and German sympathizers. In addition to these items it may be

¹ The cash disbursements for treaty purposes were approximately 2.8 billions, leaving the deficiency on account of imports at 6.2 to 7.2 billions. This sum was derived by a recalculation of the German foreign trade *value* figures. The *quantity* figures have been generally accepted; the controversy over German trade figures has concerned the method of converting paper values to gold values. The Committee's figure represents a substantial reduction below the recalculation recently made by the German government at the instigation of the Committee of Guarantees. While this is not the place to enter into a discussion of the German foreign trade figures, it must be stated that in the writer's opinion, based upon a detailed study of the relation between German exports and imports, as well as a careful reading of various memoranda bearing on the revaluation problem, the export deficiency during the post-war years is nearer 9 than 7 billion gold marks.

recalled that the Committee mention the fact that since the War some of the remaining foreign investments belonging to Germany have been utilized. No figures are, however, ventured in connection with any of these accounts.

It is therefore not possible to determine from the Committee's figures the precise amount of the total surplus in the post-war accounts. The Committee evidently arrive at their estimate of 6.75 billion gold marks of foreign holdings, plus 1.2 billions of foreign money in Germany, by adding together the unascertained surplus resulting from the trade and financial transactions, the unspecified amounts of the remnant of Germany's pre-war investments, and the unknown value of German property in the ceded areas.

As already noted, the Committee did not undertake to indicate the extent to which the 6.75 billions of foreign holdings were in a *liquid* form. At best only a rough estimate of the amount of the bank balances can be made; but it is worth making, for the light it throws on the controversial question of the flight of capital since the war, and the problem of restoring the German currency system in the future. It is clear that the remnants of Germany's pre-war foreign investments are not in the form of bank balances; her liquid investments were of course the first to be used in meeting foreign obligations. Those that now remain are not only unliquid but for the most part unproductive. The private property in the ceded territories, according to the Committee, represents "industrial assets." Therefore, the total of the bank balances can not exceed the

surplus in Germany's post-war balance of accounts. Indeed, as there is a total of 1.2 billion gold marks held in Germany in the form of foreign currency, the balances held abroad must be 1.2 billions less than the surplus in the balance of payments.

If the Committee had given figures for the amount of income from the tourist trade, remittances to Germany, shipping, insurance, the transit trade, and other like items, these sums could have been added to the 1.7 billions of surplus derived from the sale of paper marks, gold, and property, listed above. In the absence of any estimates by the Committee, these figures will have to be supplied if we are to estimate the amount of the liquid foreign assets. Rough estimates of the income derived from these sources are available.

During the years in question, the sale of securities apparently amounted to about 1 billion gold marks, and the income from the invisible sources to another billion.¹ Adding these sums to the 1.7 billions estimated by the Committee gives a total of 3.7 billions. From this must be subtracted 1.2 billion gold marks, the estimated value of foreign currency held in Germany, leaving a total of roughly 2.5 billions as the maximum amount of Germany's foreign assets that are in liquid form abroad.

This sum obviously would not have gone far in satisfying reparation demands. Moreover, if it had been so used, Germany's credit in foreign markets

¹ See Moulton, H. G., and McGuire, C. E., *Germany's Capacity to Pay*, pp. 55 and 288. (Investigations in International Economic Reconstruction, Institute of Economics, Washington.)

would have been destroyed, and the financing of the import trade would have been practically impossible. It is important in this connection to bear in mind that the accumulation of this balance was made possible only through the sale of paper marks and the sacrifice of gold and other capital assets.

The figure of 6.75 billion gold marks does not represent the net amount of Germany's foreign assets. As already pointed out, it is to a considerable extent offset by the investments of foreigners in Germany. The Committee state in the body of the report that "the real estate and securities in Germany owned by foreigners represent from 1 to 1.5 billion gold marks." In the light of the Committee's analysis this figure should really be 2.5 billions. In the annex to the report, they estimate that during the war period Germany realized about 1 billion gold marks from the sale of securities, and that since the War 1.5 billions of the deficit in the trade accounts were met by the sale of domestic securities and real estate.¹ Adding 1 to 1.5 gives 2.5, instead of "from 1 to 1.5."

¹ While this is not the place to attempt a criticism of the Committee's figures, the writer feels compelled to state that in his judgment the figure of 1.5 billions as the amount of German real estate and securities sold to foreigners since the war is an underestimate. The explanation is ventured that, having recalculated the trade figures in such a way as clearly to minimize the export deficiency, (see footnote, p. 66) the Committee found it necessary to be extremely conservative in estimating the investments of foreigners in Germany. Otherwise they would have arrived at a total of foreign holdings much in excess of what they really believed was possible.

The Committee advance no data in support of their estimate. With reference to securities, however, they make the comment that

Germany is also indebted to foreigners on other accounts. Before the War German nationals owed to foreigners—mainly for short-term credits—about 5 billion gold marks. The amount owed to Allied countries has in considerable part been liquidated through the medium of the clearing-house operations provided by the Treaty, and a large part of that owed to neutral nations has also been liquidated. On both of these accounts, however, there are still large amounts to be paid. Then, during the war, the German government and German nationals borrowed very considerable sums in neutral countries. Private debts contracted abroad during this period have practically been wiped out, but most of those contracted by the government are still outstanding.

No evidence is available to show the exact total of the obligations still outstanding, and no allowance has been made by the Committee for any liquidation of either war or pre-war debts owed to neutral countries. Such amounts as have not been liquidated in

“Germany was able during the first part of the post-war period to market some of her securities abroad, but as soon as her financial position became more uncertain most of these transactions were suspended.” The Committee here clearly confuse *bonds* and *securities*. What they say was true of bonds but not true of stocks, the sales of which have continued in large volume until very recently. As a matter of fact the sales of shares were at no time so considerable as during the winter of 1922-23, when stock prices calculated in gold were near the low point. As regards the sales of real estate, a recent investigation by the Berlin statistical office shows that foreigners up until January, 1923 had invested about 400 million gold marks in real estate in Berlin alone. It is also known that many holders of paper marks and mark credits converted their depreciating money into German property and securities.

effect offset the foreign assets which Germany still holds; such amounts as have been liquidated have required the use of German assets beyond the amounts accounted for in the Committee's report. If both of these factors had been taken into consideration, the net figure representing Germany's foreign assets would have been very materially reduced, if not completely cancelled.

There would be no point in calling attention to these omissions on the debit side of Germany's international accounts, except for the fact that they have an important bearing on Germany's future balance of payments. In view of these omissions and the fact that it is hoped to attract back to Germany the bulk of the liquid foreign assets now held abroad, it is not impossible that the annual interest which Germany owes to foreigners will in the future exceed the interest which is due her from abroad.

II. THE RETURN OF CAPITAL

The second part of the Committee's task was to consider means of bringing the "exported" capital back to Germany. On this score they say that restrictive legislation has in the main proved futile in preventing the export of capital and that "laws purporting to compel the return of capital will have the reverse effect to that which might be wished." There is no way by which a government can distinguish between bank balances held abroad for legitimate trade purposes and those held abroad for the purpose of evading confiscation by the government.

Since "neither legal enactment nor civil penalties resulted in the disclosure of assets abroad or hampered the flight of capital," the Committee conclude that the only way in which this capital can be coaxed back into Germany is by a return to sound economic conditions. With a return of government and currency stability, foreign bank balances will no longer be necessary for financing exports, and the German owner will be encouraged to bring his funds back to Germany for use in domestic undertakings. In the words of the Committee:

The only way to prevent the exodus from Germany and to encourage its return is to eradicate the cause of the outward movement. Inflation must be permanently stopped. If the issue of currency is strictly confined within the true limits of national requirements on a stable basis of value, the German with capital abroad will feel assured that he will suffer no loss in bringing it home. . . .

The method of securing a currency in Germany capable of maintaining a sufficiently stable international value covers the whole question of budgetary equilibrium and the establishment of a bank of issue on a sound basis. These matters . . . have been referred by the Reparation Commission to another Committee [the Dawes Committee] whose conclusions we have the advantage of knowing. If effect is given their recommendations we think a considerable part of the German assets now in foreign countries will return in the ordinary course of trade.

CHAPTER IV

AN APPRAISAL OF THE REVENUE FEATURES OF THE PLAN

The first test of the new reparation scheme will come in connection with the establishment of sound currency and the collection of revenue within Germany. While the transfer problem is, from one point of view, very properly emphasized as the crux of the whole matter, it is clear that unless a surplus of funds can be raised from taxation and other sources the Transfer Committee may never have an opportunity to function. Since the restoration of stable business conditions and the balancing of the budget depend so largely upon sound currency, we may consider the bank as an integral part of the new revenue system.

I. THE CURRENCY PROBLEM

There appears to be no question that a sufficient quantity of good money is available for the restoration of the German currency system. According to the estimates of the second Committee, there is now in Germany something like 1.2 billion gold marks' worth of foreign money, and the Germans have *liquid* assets abroad of approximately 2.5 billions. The international loan would make available another 800 million gold marks, and perhaps half the bank's

capital of 400 millions would be raised abroad. There is thus available for German currency purposes approximately 4.7 billion gold marks' worth of gold and foreign currency. Such a sum is considerably in excess of Germany's pre-war gold supply and is ample for bank reserve purposes. While it is hardly probable that the entire 4.7 billion gold marks can be accumulated in the German banks, there would seem to be little doubt that, with restored confidence, a sufficient portion of the total funds can be gathered in to inaugurate a new currency system.

It is true that the currency is not to be immediately convertible into gold. The plan provides for the ultimate redeemability of outstanding notes in German gold coins, in gold bars, or in "demand drafts, payable in gold, or in foreign currencies at current market gold values, and drawn on funds located abroad in solvent banks to be specified by the bank statutes." (Annex 1.) But the Committee is of the opinion that conditions will be unfavorable for such redemption at the inception of the bank. The convertibility rule may therefore be temporarily modified by an affirmative vote of every member but one of each of the following groups: (1) the Organization Committee, (2) the Managing Board, (3) the General Board. In case the currency is not made redeemable at the start, it is incumbent upon the bank to "make all possible efforts and use all the means at its disposal in order to maintain the rate of exchange of the mark at as near gold parity as possible." Actual convertibility is to be permanently

established as soon as possible "by a simple majority vote of the General Board and of the Managing Board." (Annex 1.)

It is not difficult to see why there should be hesitation about undertaking the convertibility of notes into gold at the inception of the plan. Widespread confidence must be established, or the withdrawals of gold would be so heavy as to imperil the solvency of the bank. A bad start with the new currency might, moreover, prove fatal to the entire reparation plan.

There is indeed an important reason why redemption of the paper currency into gold should not be attempted for a considerable period of time. The reparation funds will be collected within Germany in the form of paper money and deposited in the bank to the account of the Agent for Reparation Payments. The agent can not, of course, be allowed to present this paper money to the banks for redemption in gold with a view to transferring the gold to the Allies, for such a policy would quickly undermine the currency system. Large gold exports must be prevented at all hazards. Under the plan the bank is rather to loan out the reparation funds, pending their use in the purchase of bills of exchange arising from exports. Now, if the reparation agent can not present notes for redemption in gold, it would follow that German banks or individuals to whom these notes are loaned should not be allowed to present them for payment in gold. If the gold were withdrawn, it might be either hoarded or exported, thereby prejudicing reparation payments as well as the safety of the

whole currency system. There is no halfway house in the matter of redemption; all or none of the paper currency must be convertible.

Not until the reparation plan is in full operation and the existence of an export surplus removes the danger of a heavy outflow of gold, will it be safe to start redemption. Students of finance will recall the very serious difficulties encountered in the United States in the early nineties in maintaining the gold standard. An adverse balance of payments repeatedly led to the presentation of greenbacks and treasury notes to the Treasury for redemption, the gold then being shipped abroad in meeting an unfavorable balance of payments. For several years the currency system was on the brink of disaster; and eventually an international banking syndicate found it necessary not only to raise another gold loan for the support of the currency, but also to agree to do everything possible to check the flow of gold abroad. Not until the return of a favorable balance of trade with which to meet foreign obligations was the danger of a breakdown of the currency system avoided. A similar situation existed in the late seventies, and the resumption of specie payments was made possible in 1879 only by the fortunate development for the first time in several years of a large export surplus.¹

¹ For a discussion of this problem the reader may be referred to Noyes, *Forty Years of American Finance*. In Pasvolsky, Leo, and Moulton, H. G., *Russian Debts and Russian Reconstruction: (Investigations in International Economic Reconstruction, Institute of Economics, Washington)*, will be found an analysis of Russia's similar problem in the period from 1890 to 1914.

It will be the part of wisdom for the managers of the new German bank to refrain from attempting specie payments until such time as the development of an export surplus obviates the danger of any considerable outflow of specie. The rate of discount must also be maintained at a relatively high level, for the purpose of preventing an outflow of liquid funds. In a word, the flow of funds between international markets must be subject to careful control or the whole currency scheme may be disrupted. While a genuine gold standard is therefore not possible for some time to come, relatively stable currency may, however, be maintained, particularly if interested foreign governments and banking interests lend their support to the administrators of the new German bank.¹

II. THE BUDGET ESTIMATES

The Committee's report, as previously stated, is important for its enunciation of general principles rather than for the precise schedule of payments outlined. It may prove a very serious handicap to the successful administration of the plan if the emphasis that has been placed in press summaries upon the estimated revenues causes people to lose sight of the principles advanced for the control of the plan as an "indivisible whole." The Committee them-

¹ There has been a good deal of discussion as to whether the bank should be a dollar bank or a sterling bank—that is to say, whether it should be kept at a parity with gold or merely at a parity with the present British paper pound. So far as the plan itself provides, an actual gold currency is contemplated.

selves attach comparatively little importance to their own budget figures. They are recognized as only estimates—and estimates based upon a number of assumptions, some of which may not be realized, such as the rapid and complete recovery of German prosperity. In the Committee's own words—"the budget must necessarily be in the nature of an experiment."

If the experiment fails—that is to say, if the actual revenues—assuming an honest effort has been made by Germany—fall short of the estimates, then the principle that payments into the reparation account must be suspended for the benefit of the German treasury and in the interest of preserving currency stability, comes into play. It needs emphasizing that unless this principle is recognized and acted upon, the plan will not have been accepted and put into operation as an indivisible whole. Since the schedule of payments has received so much more emphasis than the principles involved, there is danger of a strong popular agitation for the application of new sanctions the moment Germany fails to raise the sums stipulated, whether the failure be due to deliberate "ca'-canny" on Germany's part or to faulty estimates on the part of the Committee. It is accordingly of the first importance that the purely tentative character of the Committee's figures be recognized, to the end that precipitate action in the event of disappointed expectations may not at an early date break down the whole plan and thereby defeat the very ends that are sought.

The truth is that not only are the Committee's esti-

mates tentative, but in some places the analysis is confused and even self-contradictory. This is, of course, not surprising in view of the evident desire to reconcile sharply divergent interests and to make the report acceptable to all concerned. Moreover, the very number of committee members and special experts would also inevitably lead to compromise, if not to contradiction in statement. It should, therefore, serve to clarify the issues that will shortly arise if some appraisal of the adequacy of the Committee's budget analysis is made at this time.

As was pointed out in Chapter I, the Committee insist that the virtual elimination of the domestic public debt makes it feasible for Germany to pay much larger sums than would otherwise have been possible. They stress the point that—

If Germany had sustained the burden of her own debt as the Allies have done, and not obliterated it by inflation, she would have had to raise 4.5 to 5 billions per annum in addition to her domestic expenditures. This would make it possible to add a provision in her budget which should bear some correspondence to the provision made in the Allies' budget for their war expenditures. (Part II, No. II (a).)

Almost immediately following this statement that Germany's paying capacity has been increased by virtue of the fact that she has obliterated her domestic debt, the Committee, however, point out that paying a domestic debt is a very different matter from paying a debt to foreigners.

In the first case the interest paid forms a part of the national income; as it is expended it provides profits and

a stimulus for internal trade and so increases further the income of the country, and in particular it is in itself an important source of internal taxation. The payment in respect of a debt due foreigners has no comparable advantages to the country making it. . . . The raising of any particular sum from one section of her inhabitants, to be paid back to another section within her borders, is a "burden" in a different sense from the payment of such a sum by the whole population to people abroad. (Part II, No. II (a).)

In the next paragraph they nevertheless conclude that the disappearance of the domestic debt—

. . . renders both practical and just a greater charge for other war debts than would otherwise have been possible. A large proportion of the richest taxpayers of the country have obtained the relief without themselves sustaining the cost. . . . They are a proper source of taxation commensurate with that weighing upon the corresponding classes in Allied countries, and in particular upon the industrial classes. To them as individual taxpayers a tax is a tax, whether its ultimate destination is the payment of a war debt due to fellow-citizens or to foreigners.

Now to the individual taxpayer a tax may be a tax, whatever its ultimate destination; but, as observed by the Committee in the preceding quotation, it makes a very great difference to the income out of which taxes must come, whether the proceeds are spent within the country or transferred to foreigners. The taxes raised by *Allied* citizens, to which reference is made, are being paid back to themselves.

As the financial editor of the *Manchester Guardian Commercial* points out, in referring to this "remarkable argument"—as he calls it—"it amounts to say-

ing that if, say, this country [England] extinguished its debt by a capital levy, it would still be able to bear the same burden of taxation as before. Inflation results in a redistribution of wealth and its natural corollary is therefore a redistribution of taxation, designed to fall most heavily upon that small section of the population which has enriched itself at the expense of the remainder. But that, surely, does not mean that inflation can atone for all its untold evils—the pauperization of the educated classes, the enfeeblement of the growing generation, the destruction of the habit of thrift, and so on—by bringing into existence a mysterious fund of wealth out of which ‘a greater charge for other war debts can be satisfied.’”¹

The most that can be said is that as a result of inflation the rich may have gained at the expense of the poor, and that hence there are some fatter geese to pluck. It is seriously to be doubted, however, whether there is any considerable class that has made and *retained* large profits as a result of the inflationary process. While the Committee propose that back taxes, so to speak, should be levied upon “windfall profits,” and that the industries should pay higher taxes, they themselves nevertheless point out that the industries have suffered losses as well as gains through the processes of inflation. The windfall profits, the second Committee finds, were not “spirited out of the country” to any great extent. They must²

¹ Manchester Guardian Commercial, April 24, 1924.

² Of the *total* foreign holdings only a small fraction could have been derived from the conversion of German profits into foreign currency. (See Chap. III.)

therefore have been utilized within the country. They were apparently utilized in part in extravagant consumption, in part in the purchase of new raw materials at prices so advanced as to nullify the gains, and in part they were used in hiring laborers, who would otherwise have been unemployed, to build additions to plant and equipment.

Only in so far as new plant and equipment constitute a source of taxable wealth can Germany's taxable capacity be said to have increased as a result of the inflation. The plant and equipment of Germany, as the Committee point out, are undoubtedly in relatively good condition. But it does not necessarily follow from this that Germany's tax-paying capacity has been proportionally increased. When business managers put surplus earnings into the extension of plant and equipment as the only means of preventing their evaporation, it is by no means certain that they will immediately be able to make an effective use of this increased plant capacity. Indeed, such expansion of productive capacity may be quite ill-advised from the viewpoint of market possibilities.

The truth is that every nation in Europe now has excess plant capacity. That is to say, plants and equipment are idle because of a lack of profitable markets, resulting from the general disorganization of trade and industry. Germany's foreign markets have been curtailed both by unfavorable economic conditions and by trade and tariff policies; and her own domestic market has been greatly reduced in consequence of the impairment of purchasing power

on the part of the middle and lower classes. It may be seriously doubted, therefore, whether those who appear, superficially, to have gained as a result of the inflation really have augmented tax-paying capacity.

As previously noted, the redistribution of wealth accompanying inflation may, however, have *slightly* increased the tax-yielding capacity of the nation. While the Committee recognize this at some places, its conclusions as to the budget are apparently based on the assumption that the elimination of the public debt has *proportionally* increased the nation's wealth and the nation's taxable capacity. The Committee's revenue estimates—at least so far as the earlier years are concerned—are therefore altogether too sanguine.

In Chapter I attention was called to the fact that for the *later* years the Committee's budget estimates were based on the assumption of a complete recovery of economic prosperity, both in Germany and in the countries with which Germany is commercially related. If this assumption is realized, we shall of course eventually have a very different situation than that outlined above, and the objection that inflation has caused great losses as well as gains would cease to have weight. By hypothesis, the losses would have been completely overcome. In such an event, the capacity to raise revenue would be as large relative to population as in pre-war days, but a smaller total would need to be raised by the country in view of the obliteration of the public debt. It would still remain true, however, that the pay-

ment of a debt to foreign countries would present a more difficult task than paying a debt of like size within the country.

III. THE RAILROAD AND INDUSTRIAL REVENUES

The Committee's discussion of the capacity of the railroads and of the industries to furnish funds for reparation purposes is even less adequate than the analysis of the budget. It is contended that the obliteration of the mortgage debt of the railroads and industries has made it possible for them to contribute directly to reparation payments. In discussing these special sources of revenue, the Committee do not even mention the difference in economic effects between internal and external payments of interest; they make the unqualified assertion that the virtual extinction of the internal mortgage indebtedness makes possible a proportional increase in external reparation payments.

The obliteration of the railroad and industrial debts has not proportionally increased Germany's capacity to pay. The extinction of these debts has been at the expense of German citizens, just as the extinction of the domestic public debt has been at the expense of German citizens. And just as it makes a great difference whether interest on the public debt is disbursed within the country or abroad, so it makes a great difference whether the interest on the railroad and industrial securities is disbursed within the country or abroad.

There are two sides to the ledger, and the Com-

mittee has had only one in view. Most of the railroad and industrial bonds were owned by the well-to-do classes, by state, municipal and other government units, and by banking and industrial corporations as such. The heaviest losers through the depreciation or liquidation of corporate indebtedness have, therefore, in some instances been the government and in other cases the financial interests themselves. A corporation or a government treasury gains from being able to pay off its own bonded obligations in depreciated currency; but it loses when its sinking fund and other bond investments are liquidated by its creditors in depreciated money.

Similarly, the individual "trust magnate" is both a borrower and an investor. As a debtor he benefits by the inflation process; as a creditor, or bond owner, he loses.¹ On the whole, the well-to-do classes would appear to have lost almost as much as they have gained—this because the masses were not to any great extent owners of bonds. The sufferings of the latter are primarily due to the failure of wages to advance in proportion to price increases.

It remains true, of course, that the obliteration of mortgage indebtedness has not destroyed factories and equipment or railroads and rolling stock, or farms and farm machinery, and it has therefore, in one sense, had no effect upon the tangible wealth of the country. Through its devastating influence upon

¹ The process of inflation has no doubt made it possible for certain individuals and groups to extend their *control* over industrial activities. This does not, however, necessarily mean much from the standpoint of *national tax capacity*.

trade and industry, the inflationary process has, however, had profound economic consequences—consequences that can not be overcome in a day. If it were true that the obliteration through the process of inflation of bond and mortgage indebtedness, both public and private, enables a country to be more prosperous than before and to pay much larger debts than would otherwise be possible, the Allied nations generally should thus seek the solution of their own economic problems.

The estimated railway revenues are open to serious question. In brief, the plan is to wipe out the present huge deficit on the German railroads and to procure within three years even larger net revenues than before the war. In 1913 railroad revenues amounted to approximately 1 billion gold marks. For purposes of comparison it may be stated that in 1921—when the mark depreciation was relatively slight—the German railroad revenues equalled about 45 billions of paper marks, and the expenses 52 billions, leaving a deficit of 7 billions, exclusive of interest charges. This paper-mark deficit is equivalent to about 300 million gold marks of pre-war values.

It is interesting to note that the enlarged railroad earnings are not to come from a reduction in wages and salaries. The estimate for staff expenses in 1924 is 1,630,000,000 gold marks, representing 54 per cent of the actual working expenditures, excluding fixed charges. While the railroads were overstaffed in the first years following the war, the number of employees has now been greatly reduced. The total in 1919 was 1,121,111; and on the first of

January, 1924, was only 936,800. A very drastic reduction is planned for the year 1924, bringing the total down to 793,000. The Committee point out, however, that this will effect no net saving, since the increase in wages will more than counterbalance the decrease in the number of employees. An 18 per cent increase in wages has been budgeted for, and the Committee state: "We feel bound to say that the increase proposed is entirely reasonable. The remuneration of the staff especially in the upper and middle ranks is quite inadequate, and if good work is expected it must be bought at its market rate."

The expectations of greatly enlarged railway revenues are based on four main considerations. First, almost no new capital expenditures on the roads will be required for several years; second, both freight and passenger rates are lower than they should be; third, efficiency of operation will be greatly increased under private management; and fourth, the traffic will be greatly enlarged when German prosperity is completely restored.

It is impossible to ascertain from the report to which of these features the Committee attribute the greatest weight. In Part I of the general report great emphasis is laid upon the advantages to be derived from proper management and unified control. It is stated that the increased revenues will not be —

. . . at the expense of the German people by increasing their fares and the cost of all goods transported by rail. It can be substantially provided by the more economical administration of the railways themselves. In saying

this, we have not in mind inadequate wages, but rather the elimination from operating and maintenance charges of certain elements of waste and also expenditure more properly chargeable to capital account. (Part I, No. IX (B).)

The elimination of waste is, however, not so strongly emphasized in the annex containing the report of the special railway experts. They emphasize the temporary gains to be derived by virtue of the fact that large capital expenditures have recently been made; but they emphasize still more strongly the desirability of raising rates and conducting the railroad system with a view to maximum earnings rather than in the interest of the industries of the country as a whole. They object emphatically to the guiding principle that has hitherto governed railroad policy and practice in Germany, namely, that the railroads "ought primarily to have regard to the progressive development of the economic life of the country and to treat the attainment of net revenue as only of secondary importance." The Committee insist that the railways must rather be worked as a commercial enterprise, that is to say, with the determination to fix the rates so as to produce all the receipts that can be obtained. They point out that both before and since the war the tariffs for passengers and freight alike have been kept too low, with the object of encouraging industry and commerce, and especially of favoring German export.

They insist on a complete break with the tradition that the railways are a key industry and that rates should be adjusted with a view to promoting general

economic prosperity. They urge again and again that the goal should be maximum revenues for the roads, rather than maximum service to the country. Still, they back water at one place where they state:

We think that a commercially managed railway company ought to treat the attainment of an adequate net revenue as of primary importance, while at the same time having regard to the progressive development of the economic life of the country, and being careful not to kill or even impair the productive capacity of the goose that lays the golden eggs. (Annex 3.)

In practice it may well be found that the high rates now so strongly urged will react disastrously upon industry, thereby lessening the possible reparation contributions from the industries.

The extent to which the special railway experts have based their estimates upon tangible evidence is best made clear by quoting their own concluding words.

The [railway] budget estimate for 1924 assumes, apparently with good reason, that the ton-kilometers to be carried in 1924 will be roughly equal to those of 1913. But conditions have greatly changed in the interval. The number of tons carried has fallen by about 20 per cent; while the distance the average ton travels has increased in corresponding ratio. . . . It is clear that, if in future years the tonnage does not increase, while the average length of haul (now about 20 per cent greater than before the war) goes back to anything approaching the pre-war figure, the effect on the railway will be quite serious.

Before we leave the question of freight tariffs we desire to make one observation. We have admitted that

the facts are obscure; that our investigations have not been and could not be pushed very far. We have acknowledged that we have hesitated as to certain conclusions. It may well be that, where we have expressed a definite opinion, time will prove the opinion wrong.

All this we have had in mind. It does not affect the thing which from the point of view of the Committee is the really important matter, that we retain the conviction that the German railways can and should produce a net revenue of one billion gold marks per annum available for reparation." (Annex 3.)

If this faith in the revenue capacities of German railways should prove misplaced, it will obviously be necessary to scale down the railway contributions to the reparation account.

IV. OVERLAPPING ESTIMATES

In concluding this brief analysis of the internal revenue features of the Committee's investigation it is necessary to point out that now and then the various parts of the revenue system are mutually antagonistic. Each source of revenue has been taken up more or less separately, and its possibilities have been considered without much reference to the effects upon alternative sources of revenue.

The exaction of direct contributions from the railroads and industries, for example, will reduce the sums that might otherwise be obtained from taxation. This is a proposition the truth of which the Committee both deny and admit. In arriving at the budget estimates, in accordance with the principle of "commensurate burden," the railroad and indus-

trial revenues were not considered as constituting a real tax burden. In concluding their general summary of the plan, the Committee write as follows.

From the standpoint of the taxpayer in Germany, the plan means a direct burden of only one-half the total sum, viz., one and one-quarter billions per year. . . . We are satisfied that the contributions from railroad and industrial debentures will not be reflected to any substantial degree in a burden to the individual German taxpayer. (Part I, No. XVII.)

More specifically with reference to the railway contribution the Committee state that—

In as much as budget revenue is not derived from profits on railways elsewhere, no question arises as to whether railway profits are a burden (in the sense of a tax). Such profits in other countries form a part of the ordinary profits of private concerns accruing to individuals; and it may be said, therefore, that in Germany the position of the taxpayer is the same whether such profits go to individuals or to the Allies as reparation. (Part II, No. II (a).)

The Committee go on to point out, however, that—

On the other hand, the German railway profits might go in relief of taxation burdens, if they were not applied to reparations. Moreover, it is difficult to say that the abstraction of the profits of so important an undertaking as the railways of a country from that country, instead of leaving them there to be enjoyed individually or collectively by the inhabitants, is not a "burden" in the international sense, even if it is not a part of the individual "commensurate burden of taxation." (Part II, No. II (a).)

The last statement, which obviously contradicts the former contentions, is clearly in accord with sound economic reasoning. It is greatly to be regretted that the Committee ignored it when making the estimates of the total sums that might be raised from *all sources*. There have merely been provided two different ways of getting payments into the reparation account. One method is to have the German people pay taxes into the federal treasury and then have the treasury turn the funds over to the reparation account. The other method is to have the people pay their money direct to the reparation account in the form of interest on bonds. Regardless of the route traveled, it comes from the German nation and goes to the Allied nations. It may, however, make some difference as to the distribution of the burden within Germany whether it is derived from general taxes or from special levies upon the railroads and the industries.

This is not the only case where the Committee have failed to keep in mind the overlapping in the different parts of their revenue plan. For example, the industries of the country are not only to make direct contributions to the reparation account, but they are also to pay taxes at increased rates with a view to swelling the budget contributions, and they are to pay the railroads much higher tariffs in order to make possible large railroad earnings.

Equally interesting is the assumption that larger contributions to the reparation account can be realized if the government pays the railroads for

parcels post and other services. In estimating the railroad revenues the Committee state that:

Our estimate takes for granted that the railways will not be required to carry traffic for the government or the community, unless their services are paid for at a commercial rate. Hitherto the German railways have carried free for the post office not only mails but parcel traffic. . . . There are other instances of a similar kind but of less importance with which it is not necessary to deal here. (Annex 3.)

This may all be very well from the standpoint of railway revenues, but this policy will only increase the government's deficit on account of the postal service, and thus lessen the contribution that might otherwise be made from the budget.

The appropriation of the transport tax for reparation purposes also affects the possible budget contributions. The proceeds of this tax—estimated to yield 250,000,000 gold marks in 1925–26, and 290,000,000 annually thereafter—are to be taken away from the German government and turned directly into the reparation account. To make good this loss of revenue in 1925–26, the government is to sell 250,000,000 marks' worth of preferred stock of the railroad companies.¹ In subsequent years the government will have to count upon increased revenues from ordinary taxation sources to make good the deficiency. The loss of this important source of revenue means that the budget contributions which can

¹ It may be recalled that the government is to sell a total of 500,000,000 marks of preferred stock in the second year, one-half of the proceeds to go directly to the reparation account.

be made will be that much less. Incidentally, it may be noted that the preferred stock to be sold the second year may not be marketable at par, as is assumed. Unless the railroad earnings are substantially above the sums required to meet the interest on the bonds, the stock may of course be expected to sell at a heavy discount.

In conclusion, it bears repeating that the Committee's plan does not stand or fall on the accuracy of their estimates as to internal revenue possibilities. As men of affairs they know quite well that it is as impossible to forecast with precision the surplus revenues that may be raised by Germany as to predict with any degree of accuracy the surplus profits of, say, the Wabash Railroad during the next forty years.

The Committee's real contribution lies in their emphasis upon the necessity (1) of recognizing the inter-relation of the currency, the budget, and the international balance of payments, (2) of establishing sound financial and economic conditions in Germany, and (3) of administering the plan as an indivisible unit and in the light of certain guiding principles. They have, moreover, set up control agencies with a view to making sure that Germany does all in her power to fulfil the obligations imposed. If time shows that the tentative estimates of the sums which can be raised without disorganizing the German finances and causing economic chaos, are excessive, it will be necessary to reduce the totals.

CHAPTER V

THE TRANSFER PROBLEM

While the problem of transferring funds to the Allies is recognized by the Committee as of crucial importance, scant attention is given in the report to the controlling factors involved. The Committee point out that the funds transferred to the Allies can not in the long run exceed the export surplus; but they do not attempt to estimate the probable future balance of payments. Nor do they discuss the factors in the German trade situation. It is true that the future balance of payments can not be definitely predicted, but it is none the less possible to indicate the factors upon which the development of such a surplus will depend. It is the purpose of the present chapter to discuss Germany's international trade problem and to focus attention on some of the vital issues which will arise in connection with the administration of the transfer of funds.

I. REPARATION PAYMENTS AND FOREIGN TRADE

The first question to be considered is whether the Committee was well advised in its conclusion that the amount of the export surplus which can be developed is unpredictable. Some writers on the reparation problem hold to a theory that an export surplus

equal to the amount of the budget surplus will automatically develop as a result of the free play of economic forces. They argue that the budget problem and the international trade problem are not distinct questions, but that they are definitely, even mathematically, related one to the other. In its usual form this theory, which is of venerable age, is substantially as follows.

Assuming the debtor country to be, as Germany has been, on an inconvertible paper-money basis, the steps in the process by which an export surplus would automatically develop are said to be these. First, the demand for foreign bills of exchange with which to make remittances will raise the price of foreign exchanges relatively to German exchange—or to state the matter the other way round—German exchange will be depreciated. Second, since commodity prices within Germany do not rise as fast as the price of foreign exchange, Germany becomes a very cheap market in which to buy. Third, low prices in Germany simultaneously discourage imports and stimulate exports, thereby depressing and curtailing the importing industries and expanding the exporting industries. Under these circumstances it is contended that the flow of goods out of Germany would be automatically increased and the flow of goods into Germany automatically diminished until the export surplus would be equal to the budget surplus.

It needs emphasizing that this analysis is based on the assumption that the mere fact that reparation payments have to be made will at once set in opera-

tion economic forces which will make possible the transfer of the funds collected within Germany. It is merely necessary to start the process. Offering large quantities of German bills in international markets depreciates the exchanges, and then everything else automatically follows in orderly procession.¹ While the theory usually assumes that the first step in the process is to balance the budget, this is not a necessary condition and some adherents of the theory make no mention of the budget. The government could raise the funds by an internal loan quite as well as through taxes, and could draw bills against the bank balances thus created. Or, for that matter, the government could sell—as in fact the German government did—bills in the form of paper marks, when no funds were available with which to redeem the bills. Any of these methods

¹ A variation of this theory is to the effect that Germany becomes a good market in which to buy, not by virtue of foreign exchange depreciation and the lag in internal price adjustments, but rather as a result of the increase in taxation. It is urged that an increase of taxes reduces the available buying power of the German people, and thereby reduces prices in Germany, and that in turn the increase in purchasing power in Allied countries will raise prices there. The rest of the way the analysis runs the same.

This doctrine that the effect of an increase in taxes, regardless of the kind of taxes imposed, will reduce prices, is apparently denied by the Committee, for they urge as one of the arguments for increasing German taxes the desirability of raising German prices to the level of other countries. It all depends on whether one looks at this problem from the point of view of mass purchasing power of consumers or from the point of view of the producing and distributing agencies on which the taxes are in first instance chiefly levied. The Committee are undoubtedly right in assuming that an increase of taxes will on the whole lead to an increase in prices in Germany.

will produce the desired first step of depreciating German exchange."

The Committee obviously give little heed to this economic theory. They intimate that the pressure to pay external obligations may tend to increase exports relative to imports, but they say that the extent to which such economic adaptation is possible over a long period of years is a mere matter of conjecture. The Committee, moreover, definitely refuse to countenance any depressing of the exchanges through the offer of large quantities of German bills in foreign markets when no export surplus is available, because experience has demonstrated that such depreciation leads to disastrous reactions upon the currency and budget of the country. The Committee keep consistently in mind the interrelation of the exchanges, the currency, the budget, and the general economic situation.

As a matter of fact, the theory of automatic salvation finds little support in the world of reality. For most of the time during the last five years, all of the conditions requisite to the working of this automatic machinery have been present. Some reparation payments have been made; German exchange has been depreciated; Germany has been a happy hunting ground for the bargain-seeker.¹ But a surplus of exports has not developed, for two reasons.

In the first place, the depreciation of the exchanges contributed to the demoralization of the German currency system and in turn to the unbalancing of

¹ This situation of course changed after stabilization was effected by the rentenmark in the late autumn of 1923.

the budget and the general economic disorganization of the country. The Committee have rendered a great service in emphasizing the interrelation of the problem, and in insisting on the necessity of regulating the transfers in the light of the actual trade situation. It may be recalled that they insist that to leave the discharge of the liability to uncontrolled events, without any possible regard to exchange difficulties, will lead to instability and disaster. "We are convinced that some kind of coordinated policy, with continuous expert administration in relation to the exchange, lies at the root of the reparation problem and is essential to any practicable scheme in obtaining the maximum sums from Germany for the benefit of the Allies." The lack of any control of these interdependent problems heretofore and the pressure for reparation payments regardless of foreign trade, currency, and budgetary conditions, has been the major cause of the instability and chaos that has existed during the past few years. There is hope for the future precisely to the extent that a coordinated policy, with continuous expert administration with regard to exchange, is developed and carried out.

In the second place, the explanation of the failure of an export surplus to develop lies in the fact that Germany does not have a group of exporting industries separate and distinct from importing industries. The typical German factory uses imported raw materials, and exports finished products made therefrom. From 80 to 85 per cent of Germany's imports before the war were composed of foodstuffs and raw

materials, the great bulk of which could not possibly be dispensed with. The dependence upon imported foodstuffs and materials is now even greater than it was in pre-war days, in consequence of the loss of the mineral resources of Alsace-Lorraine and upper Silesia and the surplus foodstuffs of Schleswig, Posen, and West Prussia. In view of the way in which the German economic system has developed, German exports are and must be made largely from imported raw materials. Industrial Germany consists of a great group of factories. The raw materials which enter into the manufacturing process must be mainly imported, and a large percentage of the population which operates the factories must be fed on imported foodstuffs. Cut off imports of foodstuffs, and a considerable percentage of the urban population of Germany will be reduced to starvation. Cut off imported raw materials, and the whole economic system will collapse.

One might just as well argue that a factory in New York City could expand its output of finished products with no raw materials entering the establishment, and with the laborers receiving no food, as to contend that the *group* of factories which make up the German industrial system could expand exports with imports of food and raw materials eliminated. No great reduction of imports is possible without disrupting the whole economic organization of Germany. Food imports may be reduced somewhat without affecting aggregate exports, but raw material imports can not be reduced at all without directly curtailing export possibilities. Nor, for that

matter, can high-priced imported raw materials be fabricated into low-priced exports.

The assumption that the importing industries are one thing and the exporting industries another is wholly unfounded in the case of Germany. Cotton, silk, and wool imports are converted into textiles and clothing; imported copper and iron emerge as manufactures of machinery, rolling stock and metal articles; imported hides and skins are employed in the manufacture of leather goods; imported woods are used in practically every type of manufacturing; certain imported chemicals and dyestuffs go into the manufacture of dyes, fertilizers, and pharmaceutical products, etc., etc. Aside from coal, sugar beets, and potash, Germany can produce no important raw products for the export trade.

From the viewpoint of national economy it is necessary for Germany, if she is to procure an export surplus, to add to the value of raw materials through the process of fabrication a sum more than equal to the cost of such portion of the nation's food-stuffs as have to be imported. If Germany had extensive resources of her own, the problem would be essentially different. If Germany had sufficient agricultural resources to take care of all her own food requirements, the problem would be essentially different. But as matters stand, German export trade is primarily dependent upon the fabrication of imported raw materials into finished products. The extent to which the export of exclusively home-grown products can be increased is very limited.¹

¹ It is not contended that the ratio of exports to imports is un-

Another phase of the argument under consideration needs a word of comment. It is assumed that the receipt of reparation payments by the Allies would give them correspondingly enlarged purchasing power, which, in view of the cheap market offered by Germany, would be expended in German markets. While this argument sounds plausible, it has already been subjected to a test since the war. Germany delivered ships to the Allies. But the receipt of these ships did not proportionally increase Allied purchasing power. It contributed directly to the depression of Allied shipping and to unemployment in Allied ship yards. The delivery of coal to France was a direct aid to France; but it reduced British markets for coal, and magnified the unemployment problem in Great Britain. We must postpone for the moment consideration of other types of payments, merely observing at this place that when reparation payments are made *other things do not remain equal*, either in Germany or in the creditor countries. It is in recognition of this fact that the Committee refer repeatedly to the possible danger that the transfers may prove prejudicial to Allied interests.

II. WILL THE NEW PLAN STIMULATE EXPORTS?

It will be interesting to consider now the effects of the Experts' plan upon the future ratio of exports to changeable and that an export surplus could under no conditions be developed. For a detailed discussion of the relation of the German import and export trade and the factors on which the development of an export surplus will depend, the reader is referred to Moulton and McGuire, *Germany's Capacity to Pay*

imports. Will exports be stimulated as a result of the reforms instituted? Is there a greater or smaller likelihood of an export surplus than has been the case heretofore—either during recent years or in pre-war days?

When the new plan becomes effective, Germany will be a much dearer market in which to buy than it has been during the last few years. Several elements of the plan combine to produce this result. First, interest rates must be kept high with a view to attract liquid funds back to Germany and to keep them there. Second, railroad freight rates are to be increased. In particular, the German practice of maintaining low freight rates on imported raw materials as well as on exports of finished products made from such materials is to be abolished, and Germany is not to be permitted to use her transportation system with a view to promote exports. Third, taxes are to be increased, particularly taxes on industry, and it is contended by the Committee that this will reduce Germany's recent competitive advantage in world markets. Fourth, the granting of subsidies for the purpose of stimulating production exports is to be a thing of the past. Finally, the exchange is to be kept stable, thus eliminating the most important cause of low prices in Germany during recent years.

It is clear, therefore, that the bargain-counter days are gone. German prices will be high relatively to those of other countries and German export trade will accordingly be handicapped. It would not follow, however, that German imports would be correspond-

ingly encouraged. The German business man who finds increased difficulty in selling abroad will hardly be disposed to increase his importations of raw materials, even though they might be procured at relatively low prices. At the same time, imports of indispensable foodstuffs and manufactured goods will be kept down by the need for economizing.

Before the war, also, the German export trade was carried on under more favorable conditions than will obtain under the new reparation plan. While German currency was not then depreciated, other sources combined to stimulate large exports. Low transportation rates on export commodities, an extraordinarily efficient sales organization, subsidies and liberal credit policies, price concessions, etc., were all designed to widen Germany's markets abroad.

There is, however, one provision, applicable during the first year of operation, that may tend to stimulate German exports. It will be recalled that the proceeds from the international loan (800 million gold marks) must be spent in Germany in part for armies of occupation, etc., and in part for goods. Whether the Allies will take kindly to this requirement, in view of the high level of prices that will shortly prevail in Germany, is an interesting speculation.

III. THE PROBLEM OF GERMAN MARKETS

Germany's problem of developing an export surplus depends not merely upon the productive capacity of the nation. Germany might find it

technically possible to create, through the process of manufacture, values sufficient in amount to cover the cost both of raw materials and of imported food-stuffs and to provide an ample margin for reparation purposes. So far as the mere production problem goes, Germany—given favoring political, social, and economic conditions—might create an export surplus of considerable size. But such a surplus will not and can not be produced unless Germany can find foreign markets for her goods. Difficult as the internal production problem may be, the market problem is even more difficult.

The Committee made no attempt to appraise market possibilities. Having ventured to point out the necessity of large exports, and having provided machinery for administering the transfer problem, they summarily closed their discussion. While this is not the place to attempt such an appraisal, a brief reference may be made to some of the controlling factors in the problem.¹

In the first place, the ability to expand export trade will depend upon the purchasing power of other countries. Despite the great economic changes that have occurred during and since the War, it remains true that Germany's ability to revive her export trade depends primarily upon her ability to sell goods in the same countries in which she sold them before the War. In 1913, 52 per cent of the total of German exports were disposed of in Western Europe, about 24 per cent in Central, Eastern, and South-

¹ For a fuller discussion the reader is referred to Moulton and McGuire, *Germany's Capacity to Pay*.

eastern Europe, and about 15 per cent in North and South America, with Asia, Africa, and Australia taking almost negligible amounts. Great Britain was the largest buyer, taking almost as much as North and South America combined.

The purchasing power of the Central, Eastern, and Southeastern European countries has been very greatly reduced as a result of the War and the general economic, social, and political disorganization that has followed in its wake. The process of recovery has thus far been disappointingly slow, to to put it mildly. The markets in Western Europe have also been very greatly curtailed, as a result of the worldwide financial and economic disorganization of recent years. Drastic economy must, moreover, continue to be practiced by these countries, if their budgets are to be balanced and their foreign obligations met. The neutral nations, while in a somewhat better position, can not buy as much as they bought before the War, in consequence of the reduction of demands for their own products in all the impoverished former belligerent countries. They, too, have been caught in the tangled web of international economic disorganization.

The Western Hemisphere would seem to offer the chief markets where sales might soon be expanded beyond the pre-war volume. Argentina and Brazil, however, have been very hard hit by the curtailment of European purchases of raw materials and foodstuffs, notably grain, hides, and coffee, while the United States, more able to buy than any other country, stands committed to a high-tariff policy.

This brings us to a consideration of the second controlling factor in the expansion of German markets, namely, the willingness of other countries generally to receive German goods. Whatever may be the economic pros and cons of the question, the fact is clear that thus far, at least, the creditor countries have not welcomed the return of German competition. Emergency tariffs, key industry acts, and anti-dumping laws have been the striking features of post-war commercial legislation. The "menace" of reviving German competition has been a perennial subject for discussion in trade circles.

The Allied nations have not merely been desirous of minimizing German competition in their own markets, but they hope to prevent Germany's re-entry into other markets. The Allied nations, including the United States, are desirous of expanding their own sales in the markets of South America, Poland, Russia, the Near East, Asia, Africa, and Australia. If Germany succeeds in recapturing an important share of the world's trade markets, it will hardly be because of Allied cooperation.

If Germany is to produce a large export surplus, it will be necessary for her to specialize in those lines of production for which the German economic organization is best adapted. Any wholesale attempt to force German competitive energy into new channels will only serve to reduce productive efficiency, raise unit costs of production, and thereby lessen German competitive capacity in foreign markets. If Germany is to export large quantities, she must

specialize in the production of those things which she can produce most cheaply.

The five principal groups of German manufactured exports and their percentages of the total exports in 1913 were as follows.

	Per cent
Iron products.....	15.8
Machinery.....	11.2
Textiles, not including clothing.....	12.7
Chemicals and dyes.....	9.4
Leather and leather articles.....	5.4

Coal, sugar, and potash, it may be repeated, are the only important products of the extractive industries that Germany has been able to produce for export.

The War has not essentially changed the nature of the German economic organization. The lines of manufacture in which the German system was most efficient before the War remain the lines in which it is most efficient now. It will be observed that the commodities in which Germany specializes are all highly competitive. The leading Allied nations, as well as the United States, are equipped to supply the bulk of the prospective demand for such products for a long time to come.

The British economist, J. A. Hobson, in a recent letter to the London *Times*, comments on this problem in the following language.

It seems essential that the policy of the German government and German industrialists shall be directed to the production of such sorts and quantities of export goods as Germans are best able to produce and the world markets able and willing to absorb. It would therefore seem wise

that in order to secure this requisite size and composition of the German export trade, the interested Allies should give some clear indication of the kinds and quantities of German goods in which they respectively desire their reparation payments to be made. Having regard to "round-about-trade" this should involve consideration of a consolidation with other foreign countries. Would it not be wise for the Allies to agree as to what trades they wish to stimulate in Germany and to damp down in their own and foreign countries? Obviously they will get most reparation if they encourage Germany to produce the manufactured goods in which her science and skill and high organization give her most advantage in production.

It must be emphasized that the lines in which Germany has the highest degree of efficiency are, with minor exceptions, the very lines in which the other leading industrial nations of the world are equipped to supply existing and potential demands. Whenever anyone has been asked to suggest important *noncompetitive* lines in which Germany is able to produce large quantities for export, the reply has been in vague generalities. The truth is that German prosperity, upon which the success of the whole plan of the Experts rests, will revive in just about the degree to which Germany is able to regain her *former* position in world markets.

At this point mention must be made of one phase of economic inter-relations to which the Committee made no definite reference, namely, the connection between Germany's internal revenues and the state of her foreign trade. The economic evolution of Germany has rendered her whole economic system vitally dependent upon international trade and ser-

vice operations. Germany's basic industries are in the main precisely those which are connected with foreign trade. Accordingly, unless German foreign trade is in a thriving condition, the German economic situation generally will be more or less depressed; and the reparation contributions from the railroads, the industries, and the national budget will suffer in consequence.

IV. GERMANY AS AN INVESTMENT MARKET

The Report of the Expert Committees affords an opportunity to consider a question that has given rise to no little discussion in economic circles. Numerous writers on the subject of reparation have contended that it is not necessary for Germany to develop an export surplus equal to the total payments made. It is argued that *legal* payments may be made in excess of the actual *economic* payments. If it is impossible for Germany to develop a large excess of exports, or if it is inconvenient for the creditor countries to receive imports in greatly increased quantities, they may invest the bulk of the sums due in German property and securities. In such a case, Germany would have to meet each year only the interest on the principal sums for which she was being credited, and the creditor countries in turn would have to receive in actual goods only the interest instalments. Final payments would thus be spread over a long period of years, or the German property might even be held as a perpetual investment. An analogy is frequently drawn between

such reinvestment of reparation funds in Germany and Great Britain's pre-war reinvestment in debtor countries of interest derived from investments there.

It has also been urged that the international loan which is to be granted to Germany as a means of rehabilitating her finances is merely the first of a whole series of loans. It is assumed that once Germany gets on her feet she may be expected to become a great investment market for the surplus capital of the United States and other countries. These arguments imply, it will be seen, that Germany is not only to be perpetually indebted to the Allies on reparation account, but to become each year more heavily indebted to the world at large. Even apart from new loans, the investment of reparation instalments within Germany would mean a constantly increasing foreign debt.

The Committee apparently do not subscribe to the view that Germany is to become a great borrowing nation and absorber of surplus loanable funds. They have fixed a maximum total for investment of reparation funds in Germany of 5 billion gold marks, stating that for both economic and political reasons a further total would be undesirable. And it may be recalled that such investments may be halted before that figure is reached. In addition, it will be borne in mind that 16 billions of railroad and industrial securities may be offered for sale abroad.

The Committee's stand in this connection is in accordance with sound economic principles. The assumption that present Germany, like the United

States of pre-war days, can absorb and meet the interest charges on increasing quantities of foreign loans is utterly fatuous. In the first place, Germany has arrived at a stage in her economic evolution where she is naturally a creditor rather than a debtor country. She was a creditor country before the War, and a part of her excess importations was met by interest on foreign investments. Her resources had been very intensively developed; she possessed no virgin territory whose exploitation required the importation of foreign capital. On the contrary, her own surplus income found more remunerative employment abroad than at home.

The events of the war and the years which have followed have not changed Germany's economic situation in this regard. Her capital equipment has not been destroyed, her population in proportion to area remains practically as dense as before, and so far as can now be foreseen no raw material resources remain to be exploited. Germany does not need a foreign loan except for the purpose of replenishing her monetary supply. Given a recovery of equilibrium, and the reestablishment of her financial system, working capital requirements could be taken care of with short-time commercial credits. Germany's great need is not to increase her foreign obligations, but to reduce them.

A second vital difference between the present German situation and that of the United States in pre-war years is this. The debt of the United States, which had been gradually accumulating over a long period of years, was the outgrowth of con-

structive financial operations. The great bulk of the funds borrowed by the people of the United States went into the development of railroad, public utility, and industrial enterprises. Capital borrowed at 4 or 5 per cent earned 6 or 8 or 10 per cent when applied to virgin American resources. The growth of our productive power increased faster than the debt obligations which were being incurred in the process, and the payment of interest ordinarily occasioned but little difficulty.

Contrast this debt problem with that of Germany at the present time. As a result of the War and the years that have followed, Germany has lost the bulk of her 20-odd billions of pre-war investments as well as a considerable part of other "invisible" income. She has also lost most of her gold supply and sold to foreigners some billions of real estate and securities. As a result of the Peace Treaty, a reparation obligation of 40 or 50 or 132 billion gold marks—nobody can say how much—has been created. The loss of the foreign investments and invisible income has been attended by no compensating gains; and the creation of the reparation obligation gave rise to no constructive economic development within Germany as did the creation of American debts in pre-war days.

Still, there are bankers and business men and economists almost without number who have the notion that Germany, with her 63 millions of popu-

¹ For a discussion of a more difficult pre-war foreign debt problem, the reader is referred to Pasvolksy and Moulton, *Russian Debts and Russian Reconstruction*.

lation on an intensively developed area two-thirds the size of the state of Texas, offers a fruitful field for the investment of foreign capital. The Committee of Experts were well advised in drawing the line on additional investments at a maximum of 5 billions, and in making it possible by a two-thirds' vote of the Transfer Committee to check investments within Germany before that sum is reached.

So far as new foreign investments in or loans to Germany are concerned, they will be quickly enough checked by Germany's inability to meet the interest obligations for want of an export surplus of sufficient size. The Expert Committees admit that there is no assurance whatever that Germany can develop a favorable balance equal to 2.5 billions a year. Unless an export surplus greater than that amount is developed or in early prospect, the security for additional loans can not be said to exist. France succeeded in liquidating some of her indemnity after 1871 by selling foreign investments and by borrowing abroad. Germany has likewise met some of her reparation obligations by selling foreign holdings and even domestic securities; and she has borrowed abroad through the flotation of German marks. But there are limits to such resources, and the limit in the case of Germany has already been reached. France had a favorable balance of payments during the seventies and was continuously able to meet interest obligations on foreign loans. Germany has no favorable balance at present, and no evidence has been adduced either by the Expert Committees or by any one else to indicate that an export surplus

equal to current reparation instalments, let alone additional interest obligations, is in prospect. The notion that Germany offers a rich investment market for foreign capital and that she can now meet her reparation obligations by credit transactions is simply an illusion.

CHAPTER VI

UNSETTLED ASPECTS OF THE REPARATION PROBLEM

The report of the Expert Committees does not cover all phases of the reparation question, nor does it definitely settle all the administrative problems with which the report was concerned. On the administrative side all that the Committee could do was to set forth the broad features of a plan. The working out of the details of the organization and the actual administration of the plan is quite another story. It may prove useful to discuss briefly certain important aspects of the reparation question which have not been covered by the report, and to focus attention upon the difficult problems of control which must yet be settled.

I. REPARATION ISSUES NOT COVERED IN THE REPORT

The work of the Committee, as we have seen, was limited by the terms of reference. For reasons of high policy the French government and the Reparation Commission apparently deemed it an inexpedient time to foster discussion of certain issues of vital importance.

First, the Committee were given no authority to fix a

total sum to be paid. It is insisted by the Allies that the total amount owed by Germany was settled once for all in 1921 and embodied in the London agreement. The amount there fixed was the present worth of a capital sum amounting to 132 billion gold marks, minus credits for payments already made for reparation plus the Belgian war debt, estimated at 4 billions, plus certain other obligations incidental to the fulfilment of the Treaty. This total remains the sum owed by Germany. The amount can legally be reduced only by the Reparation Commission itself, although the governments which the Reparation Commission serves will doubtless exercise the actually controlling influence.

As matters now stand, Germany would have to make payments perpetually and yet go ever deeper into debt. With the sum fixed in the London agreement still standing as the total obligation, the schedule of payments provided for under the experts' plan would have to be continued until the *present worth* of the capital sum fixed at London is paid. But the annual payments deemed possible and provided for under the plan, namely, 2.5 billions a year, do not cover the 6 per cent interest and sinking fund charge on *even* the 50 billions of A and B bonds provided for under the London agreement. In addition, it must be remembered that interest on the new international loan is also to be met from the annual payments of 2.5 billions. With unpaid interest piling up, it will be seen that the total German obligation would increase year by year rather than decrease.

If Germany is to be afforded any hope for an

eventual liquidation of her indebtedness—and unless such hope is given neither the Germans nor any other people can be expected to work whole-heartedly toward meeting the obligations—one or the other of two things is required. Either the total debt must be scaled down to a sum that would make possible its eventual liquidation out of the annual instalments provided in the experts' plan, or the number of years over which the plan is to run must be fixed. Two and a half billion gold marks is 6 per cent on a capital sum of about 42 billion gold marks. With annual payments of 2.5 billion gold marks (5 per cent interest and the balance for amortization) a capital sum of 42 billion gold marks would therefore be paid off in approximately 35 years.¹

A date should be fixed for terminating the operation of the plan. In view of the fact that an export surplus of *unpredictable* amount is recognized as the measure of the annual payments that can be made, it will be seen that the payment of 42 billions might in practice require a very much greater number of years than is indicated by the above computation. Since the experts recognize that the amounts that can be paid per annum are wholly unpredictable—since indeed it is not impossible that the Transfer Committee would conclude in the course of a very few years that no further payments should be attempted lest the exchanges be disorganized and the economic interests of the Allies, as well as of

¹ This computation assumes the straight payment of 2.5 billions annually, whereas the plan provides for slightly more or slightly less in accordance with an index of prosperity.

Germany, be prejudiced—it would seem that the sensible thing to do is to fix a total number of years during which the plan is to be operative, rather than to fix a total sum. It is recognized, however, that certain practical considerations with reference to control may be advanced for fixing a total sum instead.

If Germany were made to pay, over a definite term of years, the full amount of whatever export surplus she is able to develop—or such amounts as the Allies are willing to receive—this would appear to offer the greatest practical possibility of securing reparation payments. Any system which attempts to hold generation after generation of Germans in economic bondage will inevitably defeat itself. There must be a termination point somewhere within visible time, or long-sustained cooperation on the part of the German people cannot possibly be expected. A settlement of this vital question must be effected before the plan can be put into successful operation.

The second issue falling outside the Committee's instructions is the amount thus far paid by Germany. The records of the Reparation Commission credit Germany with a little more than 8 billion gold marks on reparation account. Germany claims she has made payments on reparation account proper amounting to about 45 billion gold marks, and including other treaty obligations, to over 56 billions. The Institute of Economics, after analyzing all the data available in 1923, arrived at the conclusion that, on the one hand, the German estimates were exaggerated, and, on the other, the

credits granted by the Reparation Commission were too low.

The Institute estimated that the tangible values surrendered by Germany in fulfilling treaty obligations of all sorts down to September 30, 1922, represent a loss to Germany—whatever the values actually realized by the creditors—of some 25 to 26 billion gold marks. The wide difference between the estimate of Germany and the credits granted by the Reparation Commission is explained on three main grounds. First, the German estimates are in many cases greatly exaggerated; second, the Reparation Commission's figures are admittedly provisional and incomplete, some important items not having as yet been credited; third, the Commission employed a method of valuation which, in the view of the Institute, is legally unsupportable.¹

The value of Germany's payments to date should be determined by another committee of experts. Such a committee should consist of eminent jurists, accountants, and economists drawn from neutral as well as belligerent countries, and it should be empowered to review the whole question of German payments to date. Under the terms of the Treaty, to be sure, the Reparation Commission is given the sole power to determine the sums paid. But in view of the varying estimates of the amounts thus far paid and the issues that have been raised by numerous independent investigations with reference to the methods of valuation that have been employed,

¹ Chapter III and Appendixes D, E, and F. Moulton and McGuire, *Germany's Capacity to Pay*.

there is everything to be gained and nothing to be lost—by anyone who is really interested in a practical solution of this problem—in having the sums thus far paid by Germany determined by an international committee acting independently of the Reparation Commission. There is quite as great a need for such an investigation as there was for the one just completed by the Committees whose report we are here discussing.

The third unsettled question is that of the continued occupation of the Ruhr. The Committee, as we have seen, were not empowered to consider military questions or political guarantees. They could, however—and did in emphatic language—state that their conclusions as to Germany's capacity to pay were all based on the assumption of complete freedom from external interference. The question has, therefore, naturally arisen whether the Allies can retain military control in the Ruhr, while surrendering economic control.

There is obviously room for difference of opinion on this question. There are some who honestly believe that the military occupation could be made of an "invisible" sort and that it might be conducted in such a way as to interfere not at all with Germany's industrial and financial activities. On the other hand, there are many who believe that a military occupation inevitably means friction and interference—for psychological, if for no other reasons. And they inquire not without pertinence what the precise purpose of an "invisible" military occupation would be. Why quarter Allied armies in the Westphalian

industrial district, if there is no need for controlling German activity? It would seem to be the Committee's opinion that there are enough "observers" provided for under the plan without adding to the number tens of thousands of soldiers.

In this connection it is important to distinguish clearly between different possible reasons for continuing the Ruhr occupation. As a means of collecting reparation payments, it has proved of no avail; it has merely reduced capacity to pay. The Committee's insistence that if Germany is to pay she must be given complete control of her own economic life is strong evidence of its effect. A military occupation with a view to political security is, however, an altogether different story. The occupation by a French army may conceivably be an effective means of forestalling the possibility of Germany's seeking revenge.

If the French propose to stay in the Ruhr, the reason for so doing should be made explicit. If the occupation is for the purpose of collecting reparation payments, it is, as the Committee have shown, not only unnecessary, but it will do more harm than good. If, on the other hand, the policy of France is directed by apprehension over her own security so decisively as to make some sort of military occupation seem to her indispensable, then the decision to continue that occupation should be reached in the full light of its certain interference with the extraction of reparation payments.

Without entering upon a discussion of the general problem of French security, it must be pointed out

at this place that security is one thing and reparation is another. If it is the wish of the Allied countries to procure as large reparation payments as possible, then it is necessary that French security be assured by other means than military occupation. In view of the feeling and attitude of the French people—quite understandable in the light of the past—the Allies are not without some obligation, in the interests of peace and prosperity, to give careful consideration to the French situation in this respect.

Meanwhile the withdrawal of troops from the Ruhr would at one and the same time promote the stabilization of conditions within Germany, without which the Committee sees no possibility for reparation payments, and convince those who have hitherto been harassed with doubts as to the real purpose of the occupation, that France genuinely desires to cooperate in every way possible in the solution of the reparation problem.¹

¹ The official statement of Premier Herriot on June 17, 1924, while not altogether free from ambiguity, is undoubtedly reassuring. He says, "We are hostile to the policy of isolation and force which leads to occupations and to the taking of territorial guarantees. . . . We do not think it possible to evacuate the Ruhr before the pledges provided in the experts' report, which we accept without reservation, have been, with equitable and effective guarantees of execution, constituted and handed over to organizations qualified to direct and apply them." Does this mean that the Ruhr will be evacuated as soon as Germany has done her part towards organizing the machinery recommended by the experts and instituting such fiscal and other internal reforms as are suggested? Or does it mean that the Ruhr will be evacuated only when the sums stipulated have been raised and paid into the reparation account over a considerable period of time? Presumably it means the former.

Closely akin to the problem of the present Ruhr occupation is the question of sanctions in case of German default. Since the experts were not empowered to provide for penalties or sanctions, the enforcement of the agreement in case of German default presents an unsettled issue of paramount significance. As we have seen, the Committee contented itself with saying that "it is plainly for the creditor governments, acting with the consciousness of joint trusteeship for the financial interests of themselves and of others who will have advanced money upon the lines of the plan, *then* to determine the nature of sanctions to be applied and the method of their rapid and effective application." A controversy has already arisen between the French and British over the implication of this section.

The British position is that the question of sanctions and penalties need not be considered at the present time—that it will be soon enough to raise that issue when a German default occurs. It is pointed out that this is what the word "then" in the Committee's statement implies. Former Premier Poincaré has, however, contended that in the French text of the plan there is no equivalent of the word "then," and that accordingly the penalties and sanctions should be determined *now*. He further insisted that even if there were a "then" in the French text, he would stand on the Treaty of Versailles under which the occupation of the Ruhr has been justified. His position was that Germany should be made to know precisely what England and France will do in case of default, or that, in the absence of any such advance

agreement between England and France, the latter should be left free to take what measures she may deem to be necessary.¹

The arbitration principle established in connection with railway disputes and the gold-purchasing-power index should be extended to all reparation controversies. All penalties and sanctions as a means of enforcing reparation payments have heretofore availed nothing, and in the very nature of things they can avail nothing. No threat, no application of military pressure, no seizure of territory can accomplish what economic and social conditions render impossible. The sole reliance must be placed upon the establishment of a workable plan and the creation of good will on the part of all concerned.

Many controversies will, of course, arise in connection with the administration of the plan and no little friction may be expected to develop,—even if all parties concerned are imbued with the best intentions. If bad faith and ill-will persist, these controversies will, of course, be much more serious. Such questions can not, however, be settled by the application of force. The whole plan can be wrecked within a year and the existing chaos perpetuated if a new spirit is not made to permeate the administration of the problem and if some other means of adjudicating disputes than the application of military force is not provided.

Controversy of a most serious nature is likely to arise very early in connection with the controlled

¹ See foreign correspondence of Edwin L. James, *New York Times*, April 24, 1924.

revenues. We have seen that certain important revenues are to be paid directly into the reparation account. But we have also seen that the Committee lays down the principle that if the general taxation revenues are insufficient to meet the minimum German domestic requirements—as they may well prove to be—funds can not be paid into the reparation account without disorganizing the currency system. Who is to decide whether the controlled revenues should temporarily be diverted to the German treasury with a view to prevent currency demoralization?

We have seen that in connection with railway controversies the plan provides for the submission of questions in dispute to a neutral arbitrator, nominated by the President of the Permanent Court of International Justice, and that disagreements over the gold-purchasing-power index shall be settled by an arbitral committee appointed by the League of Nations. The arbitration principle should not be confined to these problems merely. It should be made the means of adjudicating all disputes arising under, or for that matter outside, the plan. Granting the shortcomings of the arbitration method, no better means has ever been discovered for adjusting tangled human relations than to lay the matter in dispute before an impartial third person for decision.

The fourth unsettled issue is that of the interrelation between the reparation and the inter-Allied debt problems. If the Allies—particularly those countries having the largest share in the reparation claim—are to be expected to accept greatly reduced reparation sums,

the inter-Allied debt problem must also be conceived in different terms. No one has ever succeeded in doing anything but delude himself by assuming that the reparation settlement and the inter-Allied debts constitute two separate and distinct problems. The fact that they originated differently is of mere technical interest.

There will never be any final solution of the reparation problem until a comprehensive adjustment of both the international debt and reparation problems is worked out. The Expert Committees themselves point out in the closing words of their report that their plan "does not, and it could not properly, attempt a solution of the whole reparation problem." It has, however, been so framed "as to facilitate a final and comprehensive agreement as to all the problems of reparation and connected questions as soon as circumstances make this possible."

II. SOME UNSETTLED PROBLEMS OF CONTROL

Under the terms of the Treaty of Versailles the administration of the reparation problem was vested in a Reparation Commission created for that specific purpose. This Commission—except where it has been dominated by the governments whose independent agent it is supposed to be—has thus far been the control agency in reparation matters. It was accordingly the Reparation Commission which appointed the Committees of Experts, and it was to the Reparation Commission that the Committees submitted their reports. It is pertinent to inquire,

therefore, whether the various administrative committees provided for under the Experts' plan are in any way to supersede the Reparation Commission itself. Has the Reparation Commission, by accepting the Experts' report, delegated its powers to new agencies over which it will exercise no supervision? Will the Transfer Committee, as is popularly believed, become the controlling agency in the reparation problem, and will its chairman be in fact the greatest financial dictator the world has ever known?

In passing, it is of interest to note that the Reparation Commission has all along possessed the power to make precisely the sort of study of the reparation problem that the Expert Committees have now made for it. It has all along had the power to recommend an international loan for the purpose of stabilizing the German currency, to set up the Transfer Committee and others, and to gauge the annual reparation payments by the *realities* of the German budget and foreign trade situation. The Reparation Commission has never legally been debarred from doing anything that the Experts have now suggested. On the contrary, the Reparation Commission was, by the very nature of its constitution, supposed to administer the problem in such a way as to produce maximum results.

As a practical matter, however, the Reparation Commission has been faced with formidable difficulties from its very first day of operation, with little or no guidance in the way of broad principles of procedure. And before long it had become so immersed in the political aspects of the whole problem and so

bound by its previous decisions and policies that it was in a rut from which it could not directly extricate itself. A fresh start—with an entirely new set of principles for appraising the problem, and new control agencies for its administration—could be made only by resorting to some such device as the appointment of Expert Committees. And, as a practical matter, much water had to pass over the mill and the situation had to get extremely bad before it was possible in a world of economic and political illusions for Expert Committees to function.

Numerous provisions of the Experts' plan run counter to existing policies of the Reparation Commission. The first that may be mentioned is the stipulation that the annual payments shall cover *all* treaty obligations, rather than reparation obligations alone, as under the terms of the London Agreement, which did not concern itself with restitutions, "clearing house" payments, and other obligations arising under the Treaty.

A second consideration, closely related to the first, is that the interest on the foreign loan is also included within the total annual payments to be made. While the Committee does not itself pass upon the question of priority, leaving that for the underwriting syndicates to insist upon, if they deem it necessary, the loan is nevertheless placed upon a parity with other obligations. Acceptance of the plan by the Reparation Commission must mean an acceptance of both of these principles; if the plan is to be effective these principles must be observed.

Another important difference may be cited in con-

nection with the administrative provisions. The Transfer Committee *must*, under the terms of the plan, suspend the accumulation of funds within Germany when the total reaches 5 billions and the foreign exchange situation is such as to make transfers impossible. The Committee *may* also suspend the requirements before the sum of 5 billions is accumulated, by a two-thirds' majority vote of the members. While the Reparation Commission could have suspended the provisions stipulated in the London Agreement and granted Germany a moratorium, partial or complete, it was under no compulsion to do so.

It will be seen that considerations such as these raise an issue of fundamental significance. Legally, all authority in connection with the administration of reparation matters comes from the Treaty of Versailles and is vested in the Reparation Commission. Only through the latter's own formal commitment could it be legally bound by the recommendations of the Experts whom the Commission itself had appointed. As M. Poincaré, in his letter of April 25, 1924 to the chairman of the Reparation Commission, observes, "These documents were to enable the Reparation Commission to consider, in conformity with the provisions of Article 234 of the Treaty of Versailles, the resources and capacity of Germany. . . . In possession of such detailed and valued information the Commission is now in a position to pronounce judgment." That is to say, it lays with the Commission to decide what use to make of the Experts' reports.

The Reparation Commission has in fact, however, now officially accepted the report of the Experts. On April 17, 1924, the Commission unanimously decided "to approve within the limits of its powers the conclusions set forth in these reports and to adopt the methods therein recommended." Now, the question is—does the acceptance by the Commission of the principles laid down and of the machinery set up mean that the Commission ceases to be the controlling agency?

It is perfectly clear that the report of the Expert Committees assumed that the principles enunciated and the committees established are to replace existing principles and existing administrative machinery in so far as they conflict therewith. The new committees were obviously intended to have real power and were not to be merely subordinate agencies of the Reparation Commission. For example, the decision of the Transfer Committee with reference to the possibility of transferring funds without disorganizing the exchanges is, under the Experts' plan, to be final.¹ While the Reparation Commission, as indicated in Chapter II, is to retain certain adminis-

¹ In defining the powers of the Transfer Committee, the report states:

IV. The Committee shall have power, and it shall be its duty:

- (a) to apply such bank balances for payments for deliveries in kind and payments under the Reparation Recovery Act, in accordance with the programme established periodically by the Reparation Commission, after consultation with the Transfer Committee as to the character and amount of such deliveries;
- (b) to convert these bank balances into foreign currencies from time to time and, after conversion, to remit them

trative functions, its work is expected to be merely *coordinated* with that of the new committees; the decisions of the latter are not to be subject to reversal by the Commission.

In its decision of April 17, 1924, the Reparation Commission clearly accepts the principles enunciated, the new schedule of payments, and the new machinery for the administration of the problem. This act would, therefore, seem to constitute a definite amendment to the London Agreement of 1921. What we appear to have is a new subsidiary contract under the Treaty of Versailles which supersedes the London agreement, and creates new agencies of administration with independent powers. If any doubt exists as to whether the acceptance of this plan by the Reparation Commission, and in turn by the Allied governments, constitutes a "new deal," the plan itself and the agreements reached should be definitely embodied in an international protocol.

If the plan of the Committee is to be made the plaything of politicians, then little real progress will have been made as the result of the Experts' investigation. There must be no picking and choosing among the recommendations, in disregard of the solemn warning of the Committee that their plan

in accordance with the instructions of the Reparation Commission.

Both the foregoing powers (a) and (b) to be exercised to the extent to which *in the judgment of the Committee*, the foreign exchange market will permit, without threatening the stability of the German currency. (Annex 6, No. IV.)

can be successful only if it is put into effect in good faith, with singleness of purpose, as an indivisible whole, and as the one and only reparation plan under way.

Unless the whole enterprise is administered in the spirit in which it has been conceived, and unless the principle of arbitration in the adjustment of disputes replaces a system under which the creditors act at once as prosecutor, judge, jury, and bailiff, not only will those who contribute financially to its inauguration sink their funds in a forlorn enterprise, but economic chaos in Europe will be intensified. Unless the task of adjusting the remaining unsettled aspects of the reparation problem is promptly and resolutely undertaken, the valuable work of the Expert Committees will have been in vain. The real test is yet to come.

APPENDIX A

REPORT OF THE FIRST COMMITTEE OF EXPERTS

(This report, including the summary, pp. 137-145, footnotes, and the like, and the report of the second Committee, p. 293, are taken from the official English and French edition, issued by the Reparation Commission at Paris in April, 1924. The index to the reports, p. 317, has been made by the Institute of Economics.)

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SUMMARY OF PART I¹

I. THE ATTITUDE OF THE COMMITTEE

- a.* The standpoint adopted has been that of business and not politics.
- b.* Political factors have been considered only in so far as they affect the practicability of the plan.
- c.* The recovery of debt, not the imposition of penalties, has been sought.
- d.* The payment of that debt by Germany is her necessary contribution to repairing the damage of the war.
- e.* It is in the interest of all parties to carry out this plan in that good faith which is the fundamental of all business. Our plan is based upon this principle.
- f.* The reconstruction of Germany is not an end in itself; it is only part of the larger problem of the reconstruction of Europe.
- g.* Guarantees proposed are economic, not political.

II. GERMAN ECONOMIC UNITY

For success in stabilizing currency and balancing budgets, Germany needs the resources of German territory as defined by the Treaty of Versailles, and free economic activity therein.

III. MILITARY ASPECTS—CONTINGENT SANCTIONS AND GUARANTEES

- a.* Political guarantees and penalties are outside our jurisdiction.
- b.* The military aspect of this problem is beyond our terms of reference.
- c.* Within the unified territory, the plan requires that, when it is in effective operation:
 - 1. If any military organization exists, it must not impede the free exercise of economic activities;
 - 2. There shall be no foreign economic control or interference other than that proposed by the plan.
- d.* But adequate and productive guarantees are provided.

¹ The summary is furnished only for the convenience of the reader. Parts I and II and the Annexes are the only authoritative statements of the plan.

IV. THE COMMITTEE'S TASK

- a. Stabilization of currency and the balancing of budgets are interdependent, though they are provisionally separable for examination.
- b. Currency stability can only be maintained if the budget is normally balanced; the budget can only be balanced if a stable and reliable currency exists.
- c. Both are needed to enable Germany to meet her internal requirements and Treaty payments.

V. ECONOMIC FUTURE OF GERMANY

- a. Productivity is expected from increasing population, technical skill, material resources and eminence in industrial science.
- b. Plant capacity has been increased and improved since the war.

VI. CURRENCY AND A BANK OF ISSUE

- a. All classes will benefit from stabilized currency, especially labor.
- b. Under present conditions, rentenmark stability is only temporary.
- c. A new Bank is set up or the Reichsbank reorganized.
- d. The main characteristics of the Bank will be:
 1. To issue notes on a basis stable in relation to gold, with an exclusive privilege;
 2. To serve as a bankers' bank, establishing the official rate of discount;
 3. To act as the government banker, but free of government control;
 4. Advances to government to be strictly limited;
 5. To hold on deposit reparation payments;
 6. The capital of the bank will be 400 million gold marks;
 7. It will be directed by a German president and managing board, who can be assisted by a German consultative committee;
 8. The due observance of its statutes will be further safeguarded by a General Board, of which half of the members, including a commissioner, will be foreign.

VII. BUDGET AND TEMPORARY REPARATION RELIEF

Balancing the German budget requires:

- a. Full economic and fiscal sovereignty, subject to the supervision provided for in this report;
- b. A stable currency;
- c. Temporary relief from charges on the budget for Treaty obligations;
- d. Such relief not to suspend essential deliveries in kind.

VIII. THE BASIC PRINCIPLES OF GERMANY'S ANNUAL BURDEN

- a. Treaty obligations and continuity of balanced budgets.
 1. Balancing the budget does not entail merely provision for internal administrative expenditure.
 2. Germany must also provide within the utmost limit of her capacity for her external Treaty obligations.
 3. The budget can be balanced without necessarily dealing with the total capital debt of Germany.
 4. It cannot be continuously balanced, unless the annual charge is fixed for a considerable period, on a basis clearly prescribed in advance.
- b. Commensurate Taxation:
 1. Government internal debt has been practically extinguished by the depreciation of the currency.
 2. New debt charge ought to be met, commensurate with the burden of the French, English, Italian and Belgian taxpayer.
 3. The Treaty recognizes this principle.
 4. It is morally sound.
 5. It is economically just in its influence on costs of production.
 6. This principle has been applied to the full limit of practicability.
- c. Allies' share in Germany's prosperity.
 1. Germany's creditors must share in the improvement in Germany's prosperity.
 2. This will be secured by an index of prosperity.
- d. There is an important difference between the German's capacity to pay taxes and Germany's capacity to transfer wealth abroad.

IX. NORMAL RESOURCES FROM WHICH PAYMENTS ARE MADE

Germany will pay Treaty charges from three sources: A. Taxes; B. Railways; C. Industrial debentures.
A. From her ordinary budget:

1. 1924-25 budget may be balanced if it is free from Peace Treaty charges.
2. 1925-26 budget receiving 500 million gold marks from special Sources, may pay that sum for reparation.
3. 1926-27..... 110 million gold marks.¹
4. 1927-28..... 500 million gold marks.¹
5. 1928-29..... 1,250 million gold marks.

This is considered a normal year and a standard payment; thereafter additional payments will be made, depending on prosperity.

B. From Railways:

1. Railway bonds:

- a. Eleven milliards of first mortgage railway bonds against a capital cost of twenty-six milliards will be created for reparations;
- b. These bonds bear 5 per cent interest and 1 per cent sinking fund per annum;
- c. In view of reorganization, interest is accepted as follows:

1924-25:	330 million gold marks;
1925-26:	465 million gold marks;
1926-27:	550 million gold marks;
1927-28 and thereafter:	660 million gold marks.

Behind the bonds there will be created:

2 milliards of preference shares to be reserved for sale to the public and

13 milliards of common stock.

Three-fourths of the proceeds of the preference shares will be applied, as required, to the payment of debt and for capital expenditure of the railways. The remaining 500 millions of preference shares and all the common shares go to the German government.

¹ Subject to addition or reduction in certain contingencies.

2. Transport Tax.

After 1925-26, 290 million gold marks per annum for reparation, and balance to German government.

C. Industrial debentures:

1. Five milliards of industrial debentures are provided for reparation.
2. The resulting charge on industry is less than that existing before the war and now wiped out by depreciation.
3. These bonds bear 5 per cent interest and 1 per cent sinking fund, i.e., 300 million gold marks per annum.
4. Pending economic restoration, interest and sinking fund are accepted as follows:

First year.—Nothing.

Second year.—One hundred and twenty-five million gold marks.

Third year.—Two hundred and fifty million gold marks.

Thereafter.—Three hundred million gold marks.

X. SUMMARY OF PROVISION FOR TREATY PAYMENTS

a. 1. Budget Moratorium Period.

First year.—From foreign loans and part interest on railway bonds.

Total of..... 1,000 million gold marks.

Second year.—From part interest on railway bonds and on industrial debentures, budget contribution, through sale of 500 million gold mark railway shares.

Total of..... 1,220 million gold marks.

2. Transition Period.

Third year.—From interest on railway bonds and on industrial debentures, from transport tax and from budget.

Total of..... 1,200 million gold marks.

(Subject to contingent addition or reductions of 250 million gold marks.)

Fourth year.—From interest on railway bonds and on industrial debentures, from transport tax and from budget.

Total of..... 1,750 million gold marks.

(Subject to contingent addition or reduction of 250 million gold marks.)

3. Standard Year.

Fifth year.—From interest on railway bonds and on industrial debentures, from transport tax and from budget.

Total of 2,500 million gold marks.

Thereafter, 2,500 millions plus a supplement computed on the index of prosperity.

Interest on the securities, but not the proceeds of their sale, is included in these figures.

- b.* The first year will begin to run from the date when the plan shall have been accepted and put into effective execution.

XI. INCLUSIVE AMOUNTS AND DELIVERIES IN KIND

- a.* The above sums cover all amounts for which Germany may be liable to the Allied and Associated Powers.
- b.* Deliveries in kind are to be continued, but are paid for out of balances in the bank.

XII. HOW THE ANNUAL PAYMENTS ARE MADE BY GERMANY

- a.* The amounts will be raised in gold marks and paid into the bank.
- b.* These payments cover Germany's annual obligation.

XIII. HOW THE PAYMENTS ARE RECEIVED BY THE CREDITORS

- a.* Germany's creditors will use these moneys in Germany or convert them into foreign currencies.
- b.* Experience will show the rate and extent to which the conversion can safely take place.
- c.* Danger to stability through excessive remittances is obviated by a Transfer Committee.
- d.* Sums not remitted accumulate, but with a limitation of amount.

XIV. GUARANTEES, IN ADDITION TO RAILWAY AND INDUSTRIAL BONDS

- a.* The following revenues are pledged as collateral security for budget contributions and other payments:
1. Alcohol.
 2. Tobacco.

3. Beer.
4. Sugar.
5. Customs.
- b. The yield of these revenues is estimated to be substantially in excess of required payments.
- c. The excess is returned to the German government.

XV. EXTERNAL LOAN—ITS CONDITIONS AND PURPOSE

Foreign loan of 800 million gold marks meets a double purpose.

- a. Requirements of gold reserve of the new bank.
- b. Internal payments for essential Treaty purposes in 1924-25.

XVI. ORGANIZATION

The organization consists of:

- a. A Trustee for railway and industrial bonds:
- b. Three Commissioners of (1) railways, (2) the Bank, (3) Controlled Revenues;
- c. An Agent for Reparation Payments, who will coordinate the activities of the above and will preside over the Transfer Committee.

XVII. THE NATURE OF THE PLAN

- a. The plan is an indivisible unit.
- b. The aim of the plan is:
 1. To set up machinery to provide the largest annual payments from Germany;
 2. To enable maximum transfers to be made to Germany's creditors;
 3. To take the question of "what Germany can pay" out of the field of speculation and put it in the field of practical demonstration.
 4. To facilitate a final and comprehensive agreement upon all the problems of reparations and connected questions, as soon as circumstances make this possible.

REPORT OF THE FIRST COMMITTEE OF EXPERTS

We were invited by the Reparation Commission by decision of November 30, 1923, to "consider the means of balancing the budget and the measures to be taken to stabilize the currency" of Germany.

We have been in continuous session since January 14, 1924, in Paris, except for one fortnight spent in Berlin.

We have called in to assist us eminent technical advisers on the various questions which have been under consideration, and have been in touch with representative German opinion.

We have the honor to present the following report, which states the unanimous conclusions formed as a result of our studies and inquiries.

Part I of this report states our conception of our task, our conclusions, and the broad outline of our plan.

Part II indicates the considerations which guided us to our conclusions, in particular so far as they result from certain aspects of the present financial and economic condition of Germany which is here described.

Part III consists of a series of Annexes which give the technical detail of our several proposals, and should be read as a supplement to the respective portions of Part I.

PART I

THE COMMITTEE'S CONCLUSIONS AND SCHEME

I. THE ATTITUDE OF THE COMMITTEE

We have approached our task as business men anxious to obtain effective results. We have been concerned with the technical, and not the political, aspects of the problem presented to us. We have recognized indeed that political considerations necessarily set certain limits within which a solution must be found if it is to have any chance of acceptance. To this extent, and to this extent only, we have borne them in mind.

The dominating feature of the German budget is Germany's obligation to the Allies under the Treaty of Versailles. We have been concerned with the practical means of recovering this debt, not with the imposition of penalties and the guarantees which we propose are economic and not political. At the same time it is no ordinary debt with which we deal, for Germany suffered no appreciable devastation, and her primary moral obligation is toward those who have suffered so severely through the war.

As regards past history, it has not seemed necessary to establish the causes, nor the responsibility for those causes, which have operated to produce the present state of German finances and currency, except in so far as a recognition of their character is required for the prescription of remedies.

Finally, convinced as we are, that it is hopeless to build any constructive scheme unless this finds its own guarantee in the fact that it is to the interest of all the parties to carry it out in good faith, we put forward our plan relying upon this interest. We hope the character of our plan will itself assist in securing this guarantee, which is essential for its execution; but in the main, of course, it must be for others to take such measures as are necessary to maintain or assure it.

II. GERMAN ECONOMIC UNITY

The Committee has had to consider to what extent the balancing of the budget and the stabilization of the currency could be re-established permanently in Germany as she actually is at the present moment, with limitations as to her fiscal and economic rights over part of her area.

We should say at the outset that we have been unable to find any practical means of ensuring permanent stability in budget and currency under these conditions, and we think it unlikely that such means exist. The solutions of the double problem submitted to us implies indeed the restoration of Germany's credit both externally and internally, and it has appeared to us impossible to provide for this restoration under the conditions mentioned. We have, therefore, been compelled to make the assumption that the fiscal and economic unity of the Reich will be restored and our whole report is based on this hypothesis.

III. MILITARY ASPECTS

CONTINGENT SANCTIONS AND GUARANTEES

If political guarantees and penalties intended to ensure the execution of the plan proposed are considered desirable, they fall outside the Committee's jurisdiction.

Questions of military occupation are also not within our terms of reference.

It is however our duty to point out clearly that our forecasts are based on the assumption that economic activity will be unhampered and unaffected by any foreign organization other than the controls herein provided. Consequently, our plan is based upon the assumption that existing measures, in so far as they hamper that activity, will be withdrawn or sufficiently modified so soon as Germany has put into execution the plan recommended, and that they will not be re-imposed except in the case of flagrant failure to fulfil the conditions accepted by common agreement. In case of such failure it is plainly for the creditor governments, acting with the consciousness of joint trusteeship for the financial interests of themselves and of others who will have advanced money upon the lines of the plan, then to determine the nature of sanctions to be applied and the method of their rapid and effective application.

In saying this we wish to add at once that if the economic system now in operation in occupied territory is modified, we are unanimously of the opinion that a settlement of reparation must be reinforced by adequate and productive securities. We propose for this purpose a system of control which we believe will be effective, and at the same time such as not to impede the return to financial stability (see XIV below).

IV. THE COMMITTEE'S TASK

As the terms of reference indicate, two principal problems were submitted to us for inquiry: the stabilization of German currency and the balancing of the German budget. It is self-evident that these problems are interdependent. The currency of a country can not remain stable unless its budget is normally balanced, for if expenditure continually exceeds receipts there will in time be no alternative to the printing of new notes to meet the excess; and the inflation will inevitably involve depreciation. On the other hand, the task of balancing a budget, unless the currency is relatively stable, is an impossible one, for a falling currency makes calculations both of receipts and expenses unreliable, and in particular causes a continual loss to the taxing authority through the necessary interval of time between assessment and collection. While therefore in the nature of things it is necessary that the two problems should in the first instance be studied separately, their interdependence must be consistently borne in mind. In examining each of them separately, we have assumed for the minute that the other has been solved, without ever losing sight of the fact that the stabilization of the currency and the balancing of the budget are means designed to enable Germany to satisfy her own essential requirements and to meet her Treaty commitments, the fulfilment of which is so vital to the reconstruction of Western Europe. It must not be forgotten that the performance of these commitments is of vital importance, not only for the countries having a claim on Germany, but also for Germany herself. It is, indeed, clear that a Germany whose economy had again become flourishing could not long resist a financial and economic crisis in the nations surrounding her. In order that the restoration of Germany may be definitive, the other nations must also return to the conditions requisite for their financial and economic existence and must likewise be enabled to carry on the normal exchange of goods on which the general prosperity depends.

V. THE ECONOMIC POTENTIALITIES OF GERMANY

The task would be hopeless if the present situation of Germany accurately reflected her potential capacity; the proceeds from Germany's national production could not in that case enable her both to meet the national needs and to ensure the payment of her foreign debts.

But Germany's growing and industrious population; her great technical skill; the wealth of her material resources; the development of her agriculture on progressive lines; her eminence in industrial science; all these factors enable us to be hopeful with regard to her future production.

Further, even since 1919 the country has been improving its plant and equipment; the experts specially appointed to examine the railways have shown in their report that expense has not been spared in improving the German railway system; telephone and telegraph communications have been assured with the help of the most modern appliances; harbors and canals have likewise been developed; lastly, the industrialists have been enabled further to increase an entirely modern plant which is now adapted in many industries to produce a greater output than before the war.

Germany is therefore well-equipped with resources; she possesses the means for exploiting them on a large scale; when the present credit shortage has been overcome, she will be able to resume a favored position in the activity of a world where normal conditions of exchange are gradually being restored.

Without undue optimism, it may be anticipated that Germany's production will enable her to satisfy her own requirements and raise the amounts contemplated in this plan for reparation obligations. The restoration of her financial situation and of her currency, as well as the world's return to a sound economic position, seem to us essential but adequate conditions for obtaining this result.

VI. STABILITY OF THE CURRENCY

A NEW BANK OF ISSUE

We propose to deal in the first place with the currency problem.

The present financial and currency position in Germany is stated in Part II. It will be seen that by means of the Rentenmark, stability has been attained for a few months, but on a basis which, in the absence of other measures, can only be temporary.

The Committee proposes the establishment of a new bank of issue in Germany, or, alternatively, a reorganization of the Reichsbank, as an essential agency for creating in Germany a unified and stable currency. Such a currency, the Committee believes, is necessary for the rehabilitation of Germany's finances, the balancing of her budget and the restoration of her foreign credit. The principal features of the bank plan, which is printed in Annex 1, are as follows:

The bank is to have the exclusive right (with certain minor qualifications) to issue paper money in Germany for the period of its charter, fifty (50) years. All of the many kinds of paper money now circulating in Germany (except limited note issues of certain State banks) are to be gradually withdrawn from circulation, giving place to a single uniform paper currency, the bank notes of the new bank. These bank notes will be protected by a normal legal reserve of $33\frac{1}{3}$ per cent, and by other liquid assets. The reserve will be held largely in the form of deposits in foreign banks.

The plan contemplates that as a permanent policy the notes of the bank shall be redeemable in gold, but the Committee is of the opinion that at the time of the inception of the bank the situation will temporarily not allow of the application of the rule of convertibility. It therefore suggests that a currency should be created which will be kept stable in relation to gold and as soon as conditions permit be placed on a convertible basis.

Like the present Reichsbank, the new bank will serve as a bankers' bank, rediscounting the safest category of short-term bills, etc., and so establishing the official rate of discount. It will also handle for the other banks the giro system for the transfer of bank credits.

The bank will deal with the public, making short-time commercial loans and discounts, effecting transfers, and receiving deposits.

It will be the depository and the fiscal agent of the German government. It may make short-term loans to the government, but the amount and character of these loans are strictly limited, and the granting of such loans is carefully safeguarded. The German government is to participate in the profits of the bank, but the bank is to be entirely free from governmental control or interference.

Treaty funds collected in Germany are all to be deposited in the new bank to the credit of a special account and are only to be withdrawable by the creditor nations under conditions and safeguards which will adequately protect the German exchange market and the interests of the creditor nations and the German economy.

The new bank will have a capital of four hundred million (400,000,000) gold marks, part to be subscribed in Germany and part abroad. It is to be administered by a German President and a German Managing Board, which can have the assistance, as in the case of the Reichsbank, of a consultative committee. Alongside of this German Managing Board there is to be another Board, called the "General Board," which will consist of seven Germans and seven foreigners, one each of the following nationalities: British, French, Italian, Belgian, American, Dutch and Swiss. This General Board is given broad powers in such matters of bank organization and operation as might affect the interests of the creditor nations. One of the foreign members of the General Board will be known as the "Commissioner." He will be responsible for seeing that there is no infringement of the provisions relative to the issuance of notes and the maintenance of the bank's reserves. Decisions of the General Board will require a majority vote often of the fourteen members, unless both the President and the Commissioner are included in the majority, in which case a simple majority will be sufficient. Thus, cooperation by members of both groups is necessary for action.

It has been suggested in various quarters that to ensure the bank's independence of the government, an Issue Department, which could be under the direction of the Commissioner and which would be responsible for the reserve and for the issue of notes, should be established abroad. Such a guarantee is political rather than technical in character, and to propose it is outside the jurisdiction of the Committee.

A study of the Annex is essential to a thorough comprehension of the Committee's recommendations, and it has contented itself with drawing attention here to the main features to which it attaches importance.

Still assuming for the minute that the Budget problem has been successfully surmounted, we believe that our recommendations furnish a practical method, not only of stabilizing the German exchange, but of securing to German economy those credits in stable value which are essential to its reinvigoration and to the payment of reparation.

Labor also will benefit, for its interests above all are dependent upon stability. Some classes of the community may have compensations in the amazing overturn of fortunes which inflation brings—some benefit and others suffer. But for the working classes insta-

bility is wholly evil; it has no compensations whatever. In this connection, we may refer to the views expressed by the representative of labor who appeared before us in Berlin: speaking not for the whole of the German people, but merely for the class which he represented, Herr Grassmann stated that the German working classes could not stand another period of inflation. They must appeal to the world for a stable currency which would render it possible for them to buy something with their wages even four weeks after they had received them. It is clear that if the statutes of the bank are strictly observed there can be little danger of future inflation. One of the advantages to be expected is that foreign currencies immobilized in Germany, which are at present economically sterile, will be mobilized in the form of subscriptions or deposits to the bank and return to economic uses.

VII. THE BUDGET AND TEMPORARY REPARATION RELIEF

Attention may now be directed to the other main aspect of our problem, the balancing of the budget. We propose to deal first with the general budget of the Reich, and secondly and separately with the railways, which at present are contributing nothing to the general budget.

In addition to a stable currency and the economic unity defined above, the budget requires certain relief from immediate charges for Treaty purposes, which, while securing the budgetary position, will not imply the cessation of the payments indispensable to the Allies in the form of deliveries in kind.

VIII. THE BASIC PRINCIPLES OF GERMANY'S ANNUAL BURDEN

a. TREATY OBLIGATIONS AND THEIR BEARING UPON THE CONTINUITY OF BALANCED BUDGETS

It will be obvious that the balancing of the budget is, like the stabilization of the currency, of little value unless it can be maintained. It is not enough to be satisfied that one or even several budgets will be balanced. It is necessary to consider under what conditions, assuming sound administration, financial as well as currency stability can be continuously ensured, or rather under what conditions such stability once gained is likely to be endangered.

It is inevitable therefore that we should look forward, not indeed in the same detail but with proper regard to the chief determining factors, to those later years during which Germany will have gradually to liquidate her external Treaty obligations.

We repudiate, of course, the view that Germany's full domestic demands constitute a first charge on her resources and that what is available for her Treaty obligations is merely the surplus revenue that she may be willing to realize. But at the same time, if the prior obligation for reparation that is fixed for Germany to pay, together with an irreducible minimum for her own domestic expenditure, make up in a given year a sum beyond her taxable capacity, then budget instability at once ensues and currency stability is also probably involved. In that event, an adjustment of the Treaty obligations of the year is obviously the only course possible. The amount that can safely be fixed for reparation purposes tends therefore to be the difference between the maximum revenue and minimum expenditure for Germany's own needs. We shall naturally and inevitably be led to discuss later the amount of reparation payments which can be made out of budget resources and the method by which they can be effected, if the postulates of a stable currency and of a balanced budget are accepted. It would be to ignore both the plain dictates of justice, the practical conditions which must determine the acceptance or rejection of our proposals, and the context and obvious purpose of our terms of reference, if we approached our task from any other angle.

It might, indeed, be thought that if we have thus been involved in a consideration of reparation payments, it is only of such payments as are to be made during the reconstruction period of the next few years. Our task, it may be said, is to advise as to the way to attain stabilization and a balanced budget, not as to the sums to be demanded from Germany when that aim has been achieved. But no such sharp division of periods is possible, for the following reasons:

1. The basis on which the budget is balanced at the end of the reconstruction period, and the sum it includes for reparation, must obviously determine to a large extent the sums payable in the following years. Otherwise, as we have said, an equilibrium, though once attained, might be rapidly lost. The effort would have been in vain and the same problem would again present itself.

2. More important still is the fact that the success of our proposals to attain financial stabilization depends essentially upon the return

of confidence. Without this the return of German capital invested abroad, the attraction of foreign capital for the purposes mentioned in the scheme and of foreign credits for the current conduct of business, and even the proper collection of taxes, will alike be impossible.

Such confidence cannot be attained unless a settlement is now made which both Germany and the outside world believe will give an assurance that for a considerable period neither its finances nor its foreign relations will be endangered by renewed disputes. Such an assurance, as we shall see, does not mean making the charge on Germany a uniform one over a period of years, nor even deciding beforehand what the charge shall be in each of these years. But it does mean settling beforehand the method by which increases shall be determined.

When we speak of the adoption of such a method for "a considerable period," we are thinking primarily of the period which lenders and investors whose money is required as a part of our scheme will have in mind. As we shall see, our scheme needs both foreign and internal subscriptions to a Bank of Issue, and in particular an external loan as an essential condition of enabling and assuring reparation payments. We fully recognize both the necessity and the justice of maintaining the principle embodied in the Treaty that Germany's payments should increase with what may prove to be the increase in her future capacity.

We also recognize that an estimate now made once for all might well underestimate this, and that it is both just and practicable that the Allies should share in any increased prosperity. All that we regard as essential as a condition of stabilization is that any such increased demands to correspond with increasing capacity should be determined by a method which is clearly defined in the original settlement, and which is capable of automatic, or at least professional, impartial, and practically indisputable application.

This requirement we have tried to meet, as will be seen, by providing that in addition to a fixed annual payment, there shall be a variable addition dependent upon a composite index figure designed to reflect Germany's increasing capacity.

It is outside the competence of the Committee to establish a limit of years or of amount for the working of the index, nor is it within their competence to fix the number of annuities which Germany will have to pay, as this would practically mean the fixation of a new German capital debt. In any new arrangements made for a

definite settlement of the various international financial obligations arising out of the war it would be easy as regards the German debt to apply our plan to those new conditions.

b. COMMENSURATE TAXATION

We have done our utmost to apply the principle of commensurate taxation.

It is not open to dispute, as a simple principle of justice, and it is contemplated by the Treaty, that the German people should be placed under a burden of taxation at least as heavy as that borne by the peoples of the Allied countries. No single person in Germany, whether speaking as an individual or representing any section of the nation, has failed to accept that principle when it has been squarely put to him. Any limitation upon it, if there is one, must be a limitation of practicability and general economic expediency in the interest of the Allies themselves. Obviously it is morally sound; and it would be clearly repugnant to all sense of natural justice that the taxpayers of countries with large and important regions devastated by the war should bear the burden of restoring them, while the taxpayer of Germany, on whose territory the war caused no comparable devastation, escaped with a lighter burden. The principle is, at the same time, economically just, for it is obviously unfair and in every way undesirable that the Allied taxpayer should be penalized by the fact either that taxes resulting from the war weigh more heavily upon him as a consumer, or that in competition in his business he should be handicapped by greater burdens on the costs of production, including wages, than his German competitor bears.

We have borne in mind both the importance of the virtual extinction of debt in Germany and the general burden of taxation in Allied countries. As we indicate more fully in Part II, there are many difficulties in theory and practice, but in spite of them we have done our utmost to secure that the proposals we make should involve a "commensurate burden" in the fairest interpretation and application of that principle which is practicable. We are satisfied that in what we propose we are not imposing a heavier burden; we are also satisfied that we have applied the principle as far as it is practicable in the interests no less of the Allies than of Germany.

C. AN INDEX OF PROSPERITY IS NECESSARY TO ENABLE THE ALLIES
TO SHARE IN THE INCREASED PROSPERITY OF GERMANY

After a short period of recovery we believe that the financial and economic situation of Germany will have returned to a normal state, after which time the index will begin to operate.

The system of a variable annuity has the sanction of usage in the schedule of payments. But we venture to suggest for most careful consideration the advisability of altering the existing index, constituted by the value of exports. This index appears to us to be imperfect.

We are aware that there are cogent reasons both for and against any test which may be suggested, and we do not propose to examine them in detail. We are of opinion that the undoubted shortcomings of particular indices are neutralized to a large extent if a composite index is chosen, and we have a reasonable assurance that a fair measure of Germany's increasing prosperity will be obtained. Our suggestions, after considering many various alternatives for such an index, are given in Annex 2.

We take upon ourselves to recommend these suggestions, as an indication, to the attention of the Reparation Commission.

We are of opinion that at least during the period within which the loan which we propose is being amortized, the annual charge upon Germany should not be heavier than that which would result from the application of this index; nor would the Committee accept any responsibility for the balancing of the budget even in later years if heavier payments than the above were called for.

We propose that an average of years (chiefly 1926, 1927, 1928 and 1929) should be taken as the base; that the percentage increase shown by each of six sets of representative statistics (railway traffic, population, foreign trade, consumption of tobacco, etc., budget expenditure and consumption of coal) should be ascertained; and that the average of these six percentages should be taken as indicating the proportionate increase to be added to the Treaty sums demanded in a given future year.

Under this system Germany will retain her incentive to develop, as she retains the major part of the advantage of any increase in prosperity, while the Allies obtain a reasonable share in this increase and avoid the risk of losing through a premature estimate of future capacity.

At the same time, the adoption of a method involving not discretionary but automatic application, gives the necessary assurance from the commencement both to Germany and the world that Treaty demands will not, in the period to which the settlement relates, be again the subject of negotiation and dispute.

We propose, however, one further correcting factor of quite a different character which is only a precautionary measure and may never be actually involved. The Treaty prescribes Germany's obligations in terms of gold; and for convenience we have expressed our estimate in the same terms. But both the burden on Germany and the advantage to the Allies of Treaty payments consist of goods and services. Gold is only a measure of value, and over a long period of years may be an uncertain and defective one. It is only in the case of really important changes that any action is necessary and we therefore propose that a reduction or increase of the figures both as regards the standard and the supplementary payments should be made automatically in correspondence with changes in the general purchasing power of gold, whenever, by the decision of an impartial authority, such changes amount to more than 10 per cent.

*d. THE DISTINCTION BETWEEN THE TAXPAYERS' "CAPACITY TO PAY"
IN GERMANY AND GERMANY'S CAPACITY TO PAY THE ALLIES*

There has been a tendency in the past to confuse two distinct though related questions, i.e., first the amount of revenue which Germany can raise available for reparation account, and, second, the amount which can be transferred to foreign countries. The funds raised and transferred to the Allies on reparation account can not, in the long run, exceed the sums which the balance of payments makes it possible to transfer, without currency and budget instability ensuing. But it is quite obvious that the amount of budget surplus which can be raised by taxation is not limited by the entirely distinct question of the conditions of external transfer. We propose to distinguish sharply between the two problems, and first deal with the problem of the maximum budget surplus and afterwards with the problem of payment to the Allies. In the past, the varying conclusions formed as to Germany's "capacity" have often depended upon which of these two methods has been chosen.

As a first method of approach the budgetary criterion has obvious

advantages and attractions. Reparation must first be provided for as an item in the budget.

The budget itself is the sum of decisions taken by a single authority. It is capable of expert judgment and, within narrower limits of error, of calculation and analysis.

By comparison a country's "economic balance" defies exact calculation. The balance, even at a given moment, can only be estimated approximately, for the invisible exports and imports which constitute an important part of it cannot be known exactly. And a *potential* economic balance is much more uncertain. It depends not on the decisions of a single authority, but on the enterprise of individual merchants and manufacturers. Reparation demands themselves will increase it. The extent to which economic adaptation is possible over a long period of years, under the pressure of external obligations, is a matter of conjecture; an existing economic balance, before such obligations have been in operation long enough to have their effect on the economy of the country, gives a very uncertain criterion. The economic balance is therefore, by comparison with the budget, incapable of close calculation, "unmanageable" and too elastic.

But the limits set by the economic balance, if impossible of exact determination, are real. For the stability of a country's currency to be permanently maintained, not only must her budget be balanced, but her earnings from abroad must be equal to the payments she must make abroad, including not only payments for the goods she imports, but the sums paid in reparation. Nor can the balance of the budget itself be permanently maintained except on the same conditions. Loan operations may disguise the position—or postpone its practical results—but they can not alter it. If reparation can, and must, be provided by means of the inclusion of an item in the budget—i.e., by the collection of taxes in excess of internal expenditure—it can only be paid abroad by means of an economic surplus in the country's activities.

We have, it will be seen, attempted to give effect to both these sets of considerations by a method we believe to be both logical and practical. We estimate the amount which we think Germany can pay in gold marks by consideration of her budget possibilities; but we propose safeguards against such transfers of these mark payments into foreign exchange as would destroy stabilization and thereby endanger future reparation.

By comparison with a system which reduced the sums considered

possible on budget grounds because of considerations based upon estimates of the possible economic balance, this has the following advantages:

a. It enables the maximum sums to be obtained and paid to the Allies' account;

b. Any limitation upon transfers into foreign currencies will depend upon the exact economic position as it develops in fact and not upon a necessarily problematical estimate of it; and the limitation will only apply so far as it actually proves necessary;

c. Even so far as the sums paid in reparation can not be completely transferred, they can, under certain conditions, be used by the Allies for internal investment in Germany.

Above all, we recommend our proposal for these reasons: it adjusts itself automatically to realities; the burden which should rest upon the German taxpayer should, in justice, so obviously be commensurate with that borne by the Allied taxpayer that, in our view, nothing but the most compelling and proved necessity should operate to make it lighter. It would be both speculative and unjust to attempt to forecast the possibilities of the future exchange position and to determine Germany's burden in advance with reference to a problematic estimate of it. Experience, and experience alone, can show what transfer into foreign currencies can in practice be made. Our system provides in the meantime for a proper charge upon the German taxpayer, and a corresponding deposit in gold marks to the Allies' account; and then secures the maximum conversion of these mark deposits into foreign currencies which the actual capacity of the exchange position at any given time renders possible.

IX. THE NORMAL RESOURCES FROM WHICH GERMANY SHOULD MAKE PAYMENTS

With these principles in mind, we recommend that Germany should make payment from the following sources:

A. From her ordinary budget;

B. From Railway Bonds and Transport Tax;

C. From Industrial Debentures.

We proceed to consider each of these in turn.

A. PROVISION FROM THE BUDGET FOR TREATY PAYMENTS: BUDGET EQUILIBRIUM

To recommend what payments Germany can make from her ordinary budget, and from what dates, is in effect to answer the first of the two specific questions put to us, i.e., how to "balance the German Budget." For in our view, if the economic and fiscal unity of the Reich is restored, if a stable currency is established, and if the budget is given temporary relief from Treaty payments, Germany should balance her budget from her own resources by a vigorous internal effort supported by the confidence which a general and stable settlement may be expected to give, and she should thereafter be able to maintain it in equilibrium, if the future charge for Treaty payments is determined by a method which assures that it will not exceed her capacity.

In other words, we do not consider that an external loan is needed—as in the case of Austria and Hungary—to be devoted specifically to meeting ordinary deficits during a transition period. External money is indeed an essential part of our scheme, in part for the establishment of a new Bank of Issue; in part to prevent an interruption of deliveries in kind during the transition period; and essentially, to create the confidence upon which the whole success of the scheme depends. But we do not propose that it should be confined, or devoted specially, to meeting deficits on ordinary expenditure even during a transition period. On the contrary, as will be seen, we think that, from the beginning internal resources should meet internal ordinary expenditure, and at a very early date should suffice in addition to make substantial contributions towards the external debt.

The present budget position is described in some detail in Part II, which includes our criticisms and recommendations as to the measures we think practicable for economizing in expenditure and increasing taxation.

We confine ourselves here to our conclusions as to the provision that can be made for meeting Treaty payments.

1. *1924-25 Budget.* In the first year (1924-25) we consider that the ordinary budget may balance. Even if there is a deficit we are confident that it should not be such as to endanger the stability of the currency, and that at the worst the government can meet it by the orthodox expedients—increases of existing taxation, further emergency taxes and internal loans.

Even if energetic measures are taken to obviate any deficit in 1924-25 we are satisfied that neither by reduction of expenditure nor by an increase in receipts can Germany be expected to provide out of budget resources for any Peace Treaty payments to the Allies, and that any demand for their payment would imperil both the structure of the budget and the stability of the currency. How relief can be otherwise provided for the reparation creditors will be considered separately.

The fundamental importance of the effect upon the stability of the Reich budget of the finances of the States (Prussia, Bavaria, etc.) and of the Communes has greatly exercised us, and we have stated our views on the system of subsidies and local expenditure in Part II.

2. *1925-26 Budget.* On passing to the budget for 1925-26, it is obvious that the existing data are insufficient for a precise judgment on its detailed prospects. Certain general conclusions are, however, possible.

On the revenue side, the lapse of a whole year of currency stability and readjustment should of itself increase receipts. The period of recuperation will not have been long enough completely to restore the yield of the income tax, but there will at least be gold mark profits of 1924-25 on which to frame a reasonable assessment. Consumption taxes should be directly affected by returning prosperity.

On the expenditure side it may be hoped with some degree of confidence that expenditure on unemployment will exhibit a notable decrease. The expenditure on the army is capable of reduction. An automatic decrease will make itself felt in the pension charge. It is not to be expected, on the other hand, that sums thus saved on these or other heads will represent a net benefit to the budget. In particular, and this remark applies also to the budgets of the immediately succeeding years, increases in the salary charges of the Reich which can probably not be entirely offset by decreases in personnel must be anticipated.

Some increase of expenditure must therefore be expected. On balance, however, we are of opinion that the growth in receipts should be more than sufficient to counterbalance any increase in expenditure. Whatever views may be held about the eventual outcome of the 1924-25 budget, we are clear that the second year should show a substantial improvement upon it. The result of the first year therefore affects our view as to whether the result of the following year will be actually an appreciable surplus. If it should

prove that the 1924-25 budget can not be balanced by taxation alone, the improvement to be expected in the following year might not be more than sufficient to secure the balance desired. If, on the other hand, no loans were necessary in 1924-25, any improvement in the following year would be net surplus and entirely available for meeting Peace Treaty charges.

We are clearly of the view that if the two years are taken together, receipts should be sufficient to cover ordinary expenditure and we do not exclude the possibility of a small surplus. On the other hand it can not be stated with certainty that the inclusion of a compulsory liability for Peace Treaty charges will not destroy the whole balance and it is obviously vital that the mistake should not be made of fixing as a first payment during recovery a sum which the circumstances may not justify.

The stability of future reparation payments and German credit in general might thus be endangered.

There is another factor that must be taken into account. For the successful operation of the scheme for dealing with the railways to which we shall refer later, it is necessary that the proceeds of the transport tax to the extent of 250 million gold marks should be withdrawn for this year from the revenue side of the budget and devoted to the payment of Treaty charges.

On the other hand that scheme also provides for the sale by the railway company of preference shares to the nominal value of 2,000-million gold marks, one-quarter of the proceeds accruing to the profit of the German Budget and the balance providing for past and future capital expenditure of the railways. For the successful execution of the railway scheme we attach great importance to the sale to the public of these preference shares and we feel justified in assuming that before the end of the year 1925-26 the German government will be in effective possession of 500 million gold marks as a result of this transaction. The budget can therefore be reinforced to that extent and after making allowance for the withdrawal of 250 million gold marks in respect of the transport tax there will be a balance of 250 million gold marks which should be available for meeting Peace Treaty charges.

By the procedure we have indicated any danger of hampering future stability by a premature call upon the ordinary resources of the German budget will be obviated and there will be an additional inducement to transfer the preference shares to private ownership.

We therefore recommend that in the year 1925-26 Germany should

be required to meet Peace Treaty charges out of her budget to the extent of 250 million gold marks. If, contrary to our expectation, the budget fails to realize 500 million gold marks from the sale of preference shares, we consider that any resultant deficit could be met by an internal loan.

The proceeds of the transport tax should thenceforth not figure in the revenue side of the budget except to the extent to which they exceed 250 million gold marks in 1925-26 and 290 million gold marks in subsequent years.

We once more reserve the question of providing for further reparation payments by other means.

3. *The budget of later years.* As we have said already, Germany's credit can not rest upon the mere establishment of budget equilibrium. It must be clear that it can be permanently maintained. It is therefore necessary for us to consider what burden Germany can bear in the near future without danger to that equilibrium. In this connection, certain assumptions have necessarily been made. It has been considered that if for two years the budget is relieved from Peace Treaty charges and a stable currency is re-established, Germany ought in 1926 to be making rapid strides towards complete recovery, and should in three years, by 1928, reach a normal economic condition. We have taken into account the probable yield of her several taxes and her taxable capacity as a whole and the probable changes in expenditure under these improving conditions, and after making full allowance for error, we have reached definite conclusions as to the sums which can be fixed for Peace Treaty charges, without endangering the stability of the budget. These results we have considered in relation to the maximum probable rate at which the national income can be expected to grow from its present point and the maximum proportion of that growth which can successfully be absorbed in taxation.

We draw the conclusion that, allowance being made for some inevitable growth in expenditure, the budgets for the three subsequent years can safely provide for the following maximum sums:

1926-27.....	110 million gold marks
1927-28.....	500 million gold marks
1928-29.....	1,250 million gold marks

On the other hand, regard being had to the fact that it is difficult to estimate the recuperative power of Germany in 1926-27 and

1927-28, we would propose that these amounts should be regarded as subject to modification by a sum not exceeding 250 million gold marks on the following plan: if the aggregate controlled revenues as defined in Section XIV exceed 1 milliard in 1926-27 or 1,250 million in 1927-28, an addition shall be made to the above contributions equal to one-third of such excess. Conversely if those aggregate revenues fall short of 1 milliard in 1926-27 or 1,250 million in 1927-28 the total contributions shall be diminished by an amount equal to one-third of the deficiency.

We believe that at the end of the fiscal year 1928-29 the financial and economic situation of Germany will have returned to a normal state, and that in this and subsequent years the ordinary budget should support the inclusion of a sum of 1,250 million gold marks. The total sums therefore to be provided from *ordinary budget resources* would be the standard payment of 1,250 million plus the additional sum (already referred to) computed upon the Index of Prosperity, as from 1929-30 onwards.

We have considered carefully the question of the amount to which the index should be applied and, as we are desirous that in the earlier years of her recovery German progress shall not be unduly handicapped by shortage of new capital, we think that it will be desirable to apply it to the purely budget contribution 1,250 million (or one-half of the total standard payment) for the first five years of the application of the index, viz., 1929-30 to 1933-34. After that date, 1934-35, the index should apply on the full amount of the contribution, namely, 2,500 million gold marks.

B. RAILWAYS

We have conducted, with the assistance of two eminent railway experts, a close examination of the situation of the German railways. The subject is an important one, for the railways have been operated since the Armistice at a constantly increasing loss, which has involved heavy burdens upon the German budget.

Most, if not all, railway systems have passed through a period of great difficulty since the war from causes which were largely beyond their control. It is clear, however, from a study of the report drawn up by the experts, which will be found in Annex 3, that the greatest difficulties were of the Germans' own making. The German railway administration can not but plead guilty to two serious charges. In the first place, as is proved by the reduction which it is

now possible to make, they have been enormously overstaffed, even when all account is taken of the introduction of an eight-hour day and of Peace Treaty charges justifying temporary disorganization. In the second place, the administration has indulged in extravagant capital expenditure for which the official excuse is that construction was largely undertaken to ward off unemployment.

It is only just to observe that the situation has now improved out of recognition, though more remains to be done. The German government have separated the railways from the ordinary administration and assimilated them in form, so far as is possible, to a business concern. Capital construction has been slackened and fares have at any rate been raised to a point where the railways are not only self-supporting, but can provide some profit.

These measures are, however, insufficient. The capital value of the railways is estimated by the experts on a conservative basis at 26 milliards. They are unencumbered with old debts, for their prior charges were extinguished by the depreciation of the mark, and these prior charges absorbed half the gross profits in the pre-war period, which amounted to approximately one milliard gold marks, in spite of the fact that it was the custom to include in operating and maintenance charges large expenditures which might properly have been charged to capital account.

The railway experts are convinced, and we share their conviction, that under proper management, under unified control, and with a proper tariff policy, the railways can without difficulty earn a fair return upon their present capital value.

Nor need it be thought that this improvement in profits will be made at the expense of the German people by increasing their fares and the cost of all goods transported by rail. It can be substantially provided by the more economical administration of the railways themselves.

In saying this we have not in mind inadequate wages, but rather the elimination from operating and maintenance charges of certain elements of waste and also expenditure more properly chargeable to capital account.

The railway experts arrived, however, with considerable reluctance at the conclusion that it would be useless to expect anything approaching the full measure of improvement which is possible, so long as the railways remain in the control of the government. The whole spirit of the government's ownership in the past has been directed to running the railways primarily in the interest of German

industry, and only secondarily as a revenue-producing concern, and in their opinion a complete break with old traditions is essential.

We accept their conclusions and we recommend the conversion of the German railways into a joint stock company. It is not our intention thus to deprive Germany of the administration of her railways in favor of the Allies; on the contrary, our plan demands only a modest return on the capital cost, and so long as this return is forthcoming we do not anticipate any interference in the German management of the undertaking.

We would add that if, as the German government has itself proposed, the exploitation of the railways is divided into several systems, this division should not affect detrimentally their financial unity.

The details of our proposals will be found in Annex 4, and we will content ourselves with giving only a broad outline at this point.

The Committee recommends that there should be paid from the German railways, 11 milliard gold marks to be represented by first mortgage bonds bearing 5 per cent interest and 1 per cent sinking fund per annum. The capital cost of the German railways computed on a gold mark basis is estimated by our experts at 26 milliards. The net earnings of these railways before the war, after liberal and indeed exaggerated charges to operating and maintenance, were as high as 1 milliard. The interest and sinking fund on these debentures represents less than 3 per cent of the capital cost, which is a very modest charge on the capital investment compared with that required in many other countries of the world.

Realizing that during the period of reorganization of the railways, full interest and sinking fund charges should not be required, we think payments on account of interest should be as follows:

1924-25: 330 million gold marks;

1925-26: 465 million gold marks;

1926-27: 550 million gold marks;

1927-28 and thereafter: 660 million gold marks. This is regarded as a normal year.

In addition to the 11 milliards of bonds, the new railway company is to have a capital of 2 milliards of preference shares and the remainder of its capital cost, namely, 13 milliards, is to be represented by common stock. One and one-half milliards of preference shares are to be set aside in the treasury of the company, for sale to private persons to provide funds for the payment of existing indebtedness and future capital expenditures. The proceeds of the sale of the

other 500 millions of preference shares and all of the common shares are to go to the German government.

The railways are to be managed by a board of eighteen directors of whom nine will be chosen by the German government and the private holders of preference shares, and the other nine will be named by the trustee of the bonds, five of whom may be German. It is therefore contemplated that the board will have fourteen German members. The chairman of the board and the general manager of the railways will be German.

It is contemplated that the railway company will be free to conduct its business in such manner as it may think proper, provided always, however, that the German government will have such control over its tariffs and service as may be necessary to prevent discrimination and to protect the public. Such government control, however, is never to be exercised so as to impair the ability of the railway company to earn a fair and reasonable return on its capital cost.

The railway commissioner represents the interests of the bond holders. His principal duty will be, in the absence of default in interest, to receive reports, statistical and financial returns, and generally to see that the interests of the bond holders are not menaced.

C. INDUSTRIAL DEBENTURES

The Committee has been impressed with the fairness and desirability of requiring as a contribution to reparation payments from German industry a sum of not less than 5 milliards of gold marks, to be represented by first mortgage bonds bearing 5 per cent interest and 1 per cent sinking fund per annum. This amount of bonds is less than the total debt of industrial undertakings in Germany before the war. Such indebtedness has for the most part been discharged by nominal payments in depreciated currency, or practically extinguished. In addition the industrial concerns have profited in many ways through the depreciated currency, such as the long-delayed payments of taxes, by subsidies granted and advances made by the German government, and by depreciation of emergency money which they have issued. On the other hand it is incontestably true that there have also in many instances resulted losses, through the depreciation of currency, from the sale of output at fixed prices and in other ways.

It is unnecessary for the Committee to make an estimate of the total amount of such profits and losses; it is sufficient to say that the Committee is satisfied that a burden of mortgage debt of the amount of 5 milliard gold marks on the industries of Germany, fairly apportioned, bearing a moderate rate of interest and payable on long maturity, does not create a burden greater than that which would have existed had there been no depreciation of currency.

In fact the fairness of such a proposal has been recognized by the German government itself in a proposal submitted on June 7, 1923, to all the Allied and Associated governments.

This proposal was later confirmed by persons in high authority in the subsequent and present German governments.

The offer referred to above was of 10 milliard gold marks, covering business, industry, banking, trade, traffic and agriculture. The request of the Committee is for 5 milliards only and it suggests the exemption of agriculture from the obligations of the mortgage.

Realizing the importance of agriculture to a nation unable to provide its entire food supply, we feel more reserve in making a recommendation as to the burdens which should fairly be put on it, though we cannot close our eyes to the fact that a very large amount of agricultural indebtedness has been discharged at merely nominal figures and the owners of equity in land have realized substantial profits at the expense of their former creditors.

We desire to make it clear that the Committee in asking for mortgage bonds on industries does not recommend in any sense an unfair or discriminating burden against them, and so we do recommend that equalization be properly and fairly made by the German government for the benefit of its own budget. If in the opinion of the German government a burden on other property should be imposed in order to equalize the burden of reparation payments on property other than industrial property, we recommend that it be done in favor of the German budget either by a further valorization tax or by a specific lien or otherwise. If this course be followed and a fair and accurate system of direct taxation be adopted the Committee believes that all classes in Germany will be called upon to make their fair and reasonable contribution to Peace Treaty charges either through direct or indirect taxation.

Realizing the depletion of the liquid capital supply in Germany, and that a period should be provided for its recuperation, we recommend that the interest on the 5 milliards of debentures above referred to be waived entirely during the first year, that the interest

during the second year be $2\frac{1}{2}$ per cent, during the third year 5 per cent and thereafter 5 per cent plus 1 per cent sinking fund. In the event of default in the payment of interest, sinking fund or principal on any of the said debentures, provision has been made for recovery from the German government through the Commissioner of Controlled Revenues.

The plan will be found in Annex 5.

X. SUMMARY OF PROVISION FOR TREATY PAYMENTS

We are now in a position to summarize the full provision we contemplate for Treaty payments:

Budget Moratorium Period.

First year.—From foreign loan and part interest (200 millions) on railway bonds.

Total of 1,000 million gold marks.

Second year.—From interest on railway bonds (including 130 millions balance from first year) and interest on industrial debentures and budget contribution, including sale of railway shares.

Total of 1,220 million gold marks.

Transition Period.

Third year.—From interest on railways bonds and industrial debentures, from transport tax and from budget.

Total of 1,200 million gold marks.
(Subject to contingent addition or reduction not exceeding 250 million gold marks.)

Fourth year.—From interest on railway bonds and industrial debentures, from transport tax and from budget.

Total of 1,750 million gold marks.
(Subject to contingent addition or reduction not exceeding 250 million gold marks.)

Standard Year.

Fifth year.—From interest on railway bonds and industrial debentures, from transport tax and from budget.

Total of 2,500 million gold marks.

The first year will begin to run from the date when the plan shall have been accepted and made effective.

We must point out that the total figures indicated for each year must include the sums paid by the German Budget, the railway company, or the debtors on industrial debentures, whoever may be the actual recipients of these sums, the Reparation Commission, the capitalists who purchased securities, or even the debtors themselves if they have repurchased their bonds.

These figures clearly do not include the proceeds from the sale of capital assets which may be effected by the creditor governments. As soon as the plan is put into execution, the Reparation Commission will be in possession of bonds for 16 milliard marks, which may be sold to the extent to which the financial markets are capable of absorbing them. Subsequently, bonds representing the transport tax and the contribution from the budget may be issued, and will enable the governments to realize the capital of their claims.

XI. INCLUSIVE AMOUNTS—DELIVERIES IN KIND

THE INCLUSIVE NATURE OF THE PAYMENT

Before passing from this part of our report we desire to make it quite clear that the sums denoted above in our examination of the successive years, comprise all amounts for which Germany may be liable to the Allied and Associated Powers for the costs arising out of the war, including reparation, restitution, all costs of all armies of occupation, clearing-house operations to the extent of those balances which the Reparation Commission decide must legitimately remain a definitive charge on the German government, commissions of control and supervision, etc. Wherever in any part of this report or its annexes we refer to Treaty payments, reparation, amounts payable to the Allies, etc., we use these terms to include all charges payable by Germany to the Allied and Associated Powers for these war costs. They include also special payments such as those due under Articles 58, 124 and 125 of the Treaty of Versailles.

The funds to be deposited in the special account in the bank are to be available for the foregoing purposes, notwithstanding anything in this report which may be interpreted to the contrary, though in saying this we are not to be read as prejudicing questions of distribution or questions of priority between the various categories of charges.

We venture to emphasize the fact that from the point of view from which we are called upon to regard the question, these obligations of

Germany are one, and that any addition to one category of charges can only be made at the expense of another.

The Committee have noted the important fact that Germany is not in a position to ascertain her liabilities out of the Peace Treaty as demands are made upon her from time to time during the year, which cannot be calculated beforehand. It appears to us a matter of impossibility for any budget to be scientifically compiled and satisfactorily balanced under such an arrangement, and that therefore means should be found to bring this system to an end. The difficulty will be satisfactorily met if Germany's liabilities for any particular year are absolutely limited according to our plan and, as suggested above, made inclusive of all possible charges whether in or outside Germany, including the costs of the administrative controls which are set up by our plan.

DELIVERIES IN KIND

We have given special attention to the question of deliveries in kind: in their financial effects, deliveries in kind are not really distinguishable from cash payments and they can not in the long run exceed the true surplus of German production over consumption available for export without either upsetting the exchange or rendering foreign loans necessary.

Having made this clear, we have to remember that:

1. Deliveries in kind are dealt with in the Treaty.
2. They are now an inevitable part of the economic conditions of several of the Allies and can not be wholly removed without considerable dislocation.
3. If the principle is not carried too far, they may represent a stimulus to German productivity and therefore the creation of a greater export surplus.
4. They may help in avoiding such surplus being absorbed by the prior action of private German investment abroad. In this connection, the maintenance of the system of deliveries in kind, if not carried too far, may act in a manner to keep the transfer as large as possible and to give the Allies priority.

While, therefore, we recognize the necessity for the continuance of deliveries in kind, we think that unless they can be confined to natural products of Germany, such as those specifically dealt with in the Treaty (coal, coke, dyestuffs, etc.) and in the second place to exports which do not entail the previous importation into Germany

of a large percentage of their value, they tend to be uneconomic in character.

In the first two years of the operation of the plan the available finance is so restricted that there will be an automatic limitation of deliveries, but in the later period the program must be carefully and periodically considered in advance by the Reparation Commission in conjunction with the Committee referred to in Section XIII if exchange difficulties are to be avoided.

We refer below to the necessity of expending almost exclusively within Germany the sums available for Treaty payments in 1924-25 and 1925-26. In these circumstances, the Allied governments will doubtless consider whether it is not advisable to continue the system whereby the costs of armies of occupation were a first charge upon the proceeds of deliveries in kind made to the governments which maintain the armies.

Where we have referred to payments for deliveries in kind in this report we have intended to include therein payments in Germany arising through the operation of the Reparation Recovery Acts.

XII. HOW THE PAYMENTS ARE TO BE MADE

All payments for the account of Reparations (whether from interest and sinking fund on railways or industrial debentures, the transport tax, or from the budget contribution) will be paid in gold marks or their equivalent in German currency into the Bank of Issue to the credit of the "Agent for Reparation Payments." This payment is the definitive act of the German government in meeting its financial obligations under the plan. It is easier to estimate the burden that Germany's economic and fiscal resources can bear than the amount of her wealth that can be safely transferred abroad, and it is the former and not the latter that has formed the first objective of the Committee.

XIII. HOW THE PAYMENTS ARE TO BE RECEIVED

The use and withdrawal of the moneys so deposited will be controlled by a Committee, consisting of the Agent for Reparation Payments (a co-ordinating official under the Reparation Commission, whose position and duties are defined later in this report) and five persons skilled in matters relating to foreign exchange and finance, representing five of the Allied and Associated Powers. This

Committee will regulate the execution of the program for deliveries in kind and the payments under the Reparation Recovery Act, in such a manner as to prevent difficulties arising with the foreign exchange.

They will also control the transfer of cash to the Allies by purchase of foreign exchange and generally so act as to secure the maximum transfers, without bringing about instability of currency. Fuller details as to their functions will be found in Annex 6. If the payments by Germany on reparation account, in the long run, exceed the sums that can be thus transferred by deliveries or by purchase of foreign currencies, they will of course begin to accumulate in the bank. Up to a certain point, in normal circumstances not exceeding two milliards, these accumulations will form part of the short money operations of the bank.

Beyond this point, the Committee will find employment for such funds in bonds or loans in Germany under the conditions laid down in the Annex, but, for economic and political reasons, an unlimited accumulation in this form is not contemplated. We recommend that a limit of five milliards be placed upon all funds accumulating in the hands of the reparation creditors in Germany. If this limit is reached, the contributions from the budget are to be reduced below the standards set out in our plan, so that they are not in excess of the withdrawals from the account and the accumulation is not further increased. In this contingency, the payments by Germany out of the budget and the transport tax would be reduced until such time as the transfers to the Allies can be increased and the accumulation be reduced below the limit named.

We do not deny that this part of our proposal will present difficulties of a novel character which can only be solved by experience. But what are the alternatives?

In order that no difficulties with exchange or stability can possibly arise, the sum payable for reparation may be definitely fixed at such a figure as is certain beyond all doubt to be within Germany's capacity to export in excess of her imports. In this case the attainment of such certainty would involve so low a figure as to be quite unacceptable to her creditors and unwarrantably favorable to Germany.

On the other hand the liability may be fixed without regard to that excess of exports at all, and the discharge of the liability left to uncontrolled events without any possible regard to exchange difficulties. That way lies future instability and disaster.

We are convinced that some kind of coordinated policy with continuous expert administration in regard to the exchange, lies at the root of the reparation problem and is essential to any practicable scheme in obtaining the maximum sums from Germany for the benefit of the Allies.

XIV. GUARANTEES IN ADDITION TO RAILWAY AND INDUSTRIAL BONDS

It is plainly not enough to demonstrate the feasibility of raising the sums under consideration. It is desirable, in the common interest, that means should be devised for securing that the possible surplus is actually established. The greater the extent to which payment may be rendered automatic and a matter of habit, and independent of fluctuating political attitude towards reparation, the less will be the friction and the greater will be the real stability of the German budget. In the last resort the best security is the interest of the German government and people to accept in good faith a burden which the world is satisfied to be within their capacity, and to liquidate as speedily as possible a burden which is and should be onerous.

Creditors, however, are not usually satisfied with a moral security and experience and the present condition of Germany's finances are such as to reinforce their natural desire for tangible and productive guarantees.

These are no less vital in the interest of Germany herself, who will be relieved of a large part of her political troubles if the main source of political controversy is removed by a system which no longer makes the payment of reparation depend upon the constant maintenance or renewal of governmental decisions. In particular, it is vital in the interests of our scheme, which depends for its success on the assured belief of the whole world in the regular observance of a settlement once made.

On the other hand, we do not hesitate to reject as undesirable, for the purpose which all have in view, save in certain extreme events, any system which would involve directly or indirectly the virtual control of all Germany's revenue and expenditure. It would involve the controlling authority in responsibility for all financial troubles, and it might be a pretext for them.

The use of this safeguard of general budgetary control should be

reserved for the case of Germany's wilful failure to meet the obligations now laid upon her.

If, as we believe, the payments which we have suggested can be made without compromising budget stability, it is in our opinion not impossible to establish a system under which a combination of self-interest and latent pressure will suffice to assure sound financial administration. We believe that the object can be attained if, without in any way impairing the first charge which now exists in favor of reparation on all Germany's assets, certain specific revenues are assigned to, and under the control of, Germany's creditors. These revenues will furnish a collateral, but not a primary, security and we suggest that they should be the taxes on customs, alcohol, tobacco, beer and sugar.

We propose for this purpose that they should pass directly into the hands of an impartial and effective control; that the Treaty payments should first be deducted by the controlling authority for the account of the Allies; and that Germany should only have the use for her own purposes of such balance as may remain.

We believe that this system contains the greatest degree of effectiveness without involving the Allies in the onus of responsibility for any breakdown in the execution of the plan.

We recommend that the control should be instituted forthwith in spite of the fact that the budget supports no Peace Treaty charge in the year 1924-25.

We make this recommendation for two reasons: Germany, by instituting this control, puts this part of the plan into execution in a definite and public manner, and in the second place early action will ensure that control is in effective operation at the moment when part of the revenues is retained by Germany's creditors.

We would add that while leaving untouched the existing alcohol monopoly, we do not, in view of reports received from technical experts, propose the transformation of consumption duties into new monopolies, though we recommend certain important new regulations with regard to the sale of tobacco.

CONTROLLED REVENUES: THEIR YIELD

The estimate made by the German officials of these revenues for the year 1928-29, exclusive of customs, was 1,700 million gold marks.

The technical advisors specially consulted by the Committee have estimated the yield at 2,146 million gold marks.

There is every prospect, therefore, that the assigned and controlled revenues will give a large margin over the Treaty charge payments, even in the standard year, of 1,250 million gold marks. The revenues are a *security* for a payment otherwise fixed. This principle renders possible a system of control which, while equally effective, is much more simple in operation, and is strengthened by the association of Germany's self-interest. Once the Treaty charges are met she is entitled to the whole balance and therefore she has the fullest inducement to increase the yield. But she can touch no part of the revenues in a given period until the Treaty charges are fully met; so that every increase operates in the first instance to increase the Allies' security.

We have suggested above that in the years 1926-27 and 1927-28 the amount of reparation to be paid should be dependent to some extent on the yield of these particular revenues. In order that there may be no misunderstanding, we desire to state clearly that in our opinion this arrangement should be strictly confined to the two years in question and be regarded as exceptional.

We believe it to be of the greatest importance that the revenues should normally be regarded strictly as security, and should not be relied upon in the ordinary course as the determinant of the actual sum to be paid as reparation. In particular, if the yield of the revenues exceeds the amount to be secured, the excess should accrue to the German government. Our reasons for holding these opinions are more fully stated in Part II.

XV. EXTERNAL LOAN

ITS CONDITIONS AND PURPOSE

An integral part of our scheme is the issue by Germany of a foreign loan of 800 million gold marks; this loan is primarily essential for the successful establishment of the new bank and to ensure the stabilization of the currency. The deposit of this amount in the new bank will be an important and necessary contribution to its gold reserves and enlarge the basis of its currency issues. It will thus be enabled in the second place, without impairing its usefulness for the above, to play an important part in solving the problem created by Germany's immediate and more urgent obligations to the Allies which do not necessitate the transfer of money abroad.

We have already stated our conclusion that Germany should not be called upon in the years 1924-25 and 1925-26 to provide for any Treaty charges out of ordinary budget resources, and we have deferred to this point indication of means by which a complete suspension of payments may be avoided.

The current liabilities of Germany under the Treaty other than liabilities for cash payments in foreign currencies, comprising the most essential deliveries in kind, and costs under a number of other heads, are known to be considerable. Although their precise amount is not easily determinable, they aggregate to a large amount and if no arrangement is made for meeting or reducing them they form a formidable obstacle in the way of a complete solution.

In the year 1924-25 the extra-budgetary resources can be relied upon to provide 200 million gold marks, being interest on railway bonds. The question arises whether a further sum can be provided.

We first considered whether Germany would have sufficient credit at the outset to meet the full amount of her charges by loans or capital assets. In our view, it is impossible to say that she could obtain funds, until her position is well established, adequate to discharge them. But it does not follow that the most pressing of the demands can not be met, for a considerable sum can certainly be raised upon the good security that the plan provides, with a clear prospect of improved international political position and of stability. The question is, therefore, whether the claims upon Germany can be so reduced by agreement among the Allied creditors as to come within this potential credit. If they can, then obviously the greater the reduction, the more moderate the sum to be raised and the greater the probability of Germany successfully raising a loan. If not, then the loan will not be forthcoming, stability can not be ensured, and neither this plan nor any other can come into being. The successful launching of the scheme depends therefore upon three main factors:

a. Limitation of payments for all purposes to 1,000 million gold marks, of which at least 800 millions must be spent in Germany for the first year, and thereafter to such sums as are available under the plan during the succeeding years;

b. Co-operation between the Allies and Germany in securing political conditions which will incline the investors of the world favorably towards the German loan upon good security; and

c. A loan of 800 million gold marks which will serve the double purpose of assuring currency stability and financing essential deliv-

eries in kind during the preliminary period of economic rehabilitation.

It will be seen that under the plan, among the different revenues available, ample and sufficient security could be found to form the basis of such a loan, both as to interest and sinking fund.

Obviously, the first loan should be fully secured, but it is equally true that it is neither in the interest of a first loan nor of the Reparation Commission to create a situation which would prejudice the flotation of subsequent German loans or the realization of the capital assets provided for in the plan.

The amount required for the service of this first and any subsequent loans must be deducted from the sums which in subsequent years can, in accordance with our plan, be placed at the disposal of Germany's creditors. In effect the loan is only an anticipation of the sums subsequently available which, it is necessary to emphasize, represent in our opinion the maximum burden and therefore one not capable of increase.

It is not for us to offer suggestions as to the priority of claims or how the sums should be distributed. On this aspect of the matter we confine ourselves to stating that in the interest of currency stability and to aid the successful inauguration of the new bank, the proceeds of the loan should be used exclusively for financing internal payments, such as deliveries in kind (whether direct or by the operation of the Reparation Recovery Act), and that part of the costs of the armies of occupation which represents expenditure in Germany by or on behalf of these armies. But we do assert that, if as we believe, Germany's credit will be good enough to float such a loan, it is natural and necessary that her credit should be employed to ease the burden on her creditors during the period of her own recovery.

In the year 1925-26 the problem is somewhat different in character. The reasons which make a foreign loan essential in the first year should have disappeared. If confidence is in process of re-establishment a large reflux of capital to Germany is to be expected. People whose object in transferring money abroad or in hoarding foreign notes within Germany has been simply to ensure against further loss, will, to a great extent, reconvert this capital into German currency. Other things being equal, the German currency and exchange situation will continue to improve, a phenomenon which has been clearly exhibited in the last twelve months in Austria.

The exchange position of Germany will, therefore, be relatively

strong and her budget position relatively weak. In the few succeeding years the position will be exactly reversed; the exchange will become normal, but weaker than during the abnormal period of reconstruction, while budget resources should be enormously strengthened.

In view of these facts, we see no danger, and perhaps positive advantage, in requiring that during 1925-26 deliveries in kind and that part of the costs of the armies of occupation spent in Germany by or on behalf of the armies, should be financed up to 1,220 million gold marks by sums raised in Germany itself.

The above sum is made up of (1) railway interest, partly carried over from the first year, amounting to 595 million gold marks (2) the transport tax to the amount of 250 million gold marks, (3) interest on industrial debentures amounting to 125 million gold marks and (4) 250 million gold marks from the budget provided by the sale of Railway Preference Shares belonging to the German government. If for any reason the whole of the above sums are not provided, the balance should be raised by a German internal loan.

XVI. ORGANIZATION

The Committee's plan provides for a Commissioner of the Bank of Issue, a Commissioner of Railways, a Commissioner of Controlled Revenues, the last-named to have under his control a certain number of sub-commissioners severally entrusted with the special revenues under consideration; and if the need arise, for a Commissioner of Industrial Debenture.

The plan also provides for an Agent for Reparation Payments.

In order that the machinery thus set up by our plan may function properly, both in relation to the Reparation Commission and in its German environments, there must be an agency between the Reparation Commission and the various commissioners. We suggest that this coordinating agency devolve upon the Agent for Reparation Payments.

The Commissioners would retain all responsibility for the carrying out of the task entrusted to each, only subject to such coordinating policies as may prove necessary in order to avoid any duplication of effort, overlapping of functions, unnecessary friction and generally all interference with the harmonious working of our plan.

In case of a difference of opinion between one Commissioner and

the "Agent General for Reparation Payments" in his capacity as coordinator, the Commissioner can appeal to the Reparation Commission. The existence of this right of appeal will have a salutary effect upon the relations of the coordinating agency and the different Commissioners.

To facilitate the interchange of information which will develop a situation in its entirety for appropriate action a general coordinating board is also suggested in which the various Commissioners or representatives named by them will participate together with the "Agent for Reparation Payments" and the Trustee. The coordinating board is to have advisory powers only and is for the purpose of giving information to the Agent General to assist him in preparing coordinating orders.

These suggestions are naturally far from exhausting this important subject, one of the most important of our plan. They are laid down simply as an indication, as the drafting of the rules for such a coordination will devolve upon the Reparation Commission so far as they have power, and upon the various governments.

Rules should be laid down for the rendering of periodical reports and for the publication of such as the public interest may require.

We desire, however, to record in this connection that the expense of the new machinery provided for by the plan can and should be contained within limited amounts and in any case be included in the annuities already contemplated.

Trustee. The plan also provides for the appointment of a Trustee with the following duties.

He will receive and administer the railway and industrial bonds and will be accountable to the Reparation Commission for these and all other securities.

He will ensure the service (interest and amortization) of the railway and industrial bonds by means of funds remitted to him for this purpose by the Agent for Reparation Payments.

He will fix the conditions of the amortization of the bonds and if necessary the redemption at par of all or a part of the bonds not yet amortized by means of any supplementary payments which may be made by the German government, the railway company or industry.

With the authorization of the Reparation Commission and for its benefit, the Trustee may sell the bonds which he holds, and may use the mortgage bonds and deeds which he holds to secure new securities which he may himself issue.

Both the Agent and the Trustee should be appointed by the Reparation Commission.

In framing the organization of control the Committee has adopted as fundamental the principle that if the plan is to yield the best financial results, it is desirable that control should be of such a nature as not to involve the assumption of responsibility by the Commissioner for German administration, though the Committee recognize that this principle can not be adhered to in case default under the plan arises.

XVII. THE NATURE OF THE PLAN

In concluding this part of our report there are several points which we desire to emphasize.

In the first place we regard our report as an indivisible whole. It is not possible, in our opinion, to achieve any success by selecting certain of our recommendations for adoption and rejecting the others, and we would desire to accept no responsibility for the results of such a procedure nor for undue delay in giving execution to our plan.

In the second place, as we have remarked earlier, our plan is strictly dependent upon the restoration of Germany's economic sovereignty, and it is important to observe that the operation of the plan will be proportionately postponed if there is a delay in effecting that restoration. The various dates which we mention in the report must be interpreted in the light of the above remark.

From the standpoint of the taxpayer in creditor countries the plan means in due course an annual relief to the extent of two and one-half milliards, plus such additional amount as the index of prosperity may provide.

On the other hand from the standpoint of the taxpayer in Germany the plan means a direct burden of only one-half this sum, viz., one and one-quarter milliards per year, and the transport tax, plus such additional amount as may represent only a relatively small share in increased prosperity. The German taxpayer can look without anxiety upon the remainder of the payment of two and one-half milliards, for it represents a relatively small burden on German industry, which has been the beneficiary of substantial special profits and only a modest return on a large capital invested in railroads which are yielding him no relief in taxation in his budget at present, such capital having been accumulated prior to the war.

We are satisfied that the contributions from railway and industrial debentures will not be reflected to any substantial degree in a burden to the individual German taxpayer; as regards the railways it will require the same kind of return as exists in similar enterprises in many countries.

Our purpose has been to set up a machinery which will secure the maximum payment which Germany can make in each year in her own currency. We do not speculate on the amount which can annually be paid in foreign currency or on Germany's capacity to make a total payment.

The Committee is confident that it lies within the power of the German people to respond to the burdens imposed by the plan, without impairing a standard of living comparable to that of the Allied countries and their neighbors in Europe, who are likewise subject to heavy burdens, largely resulting from the catastrophe of the war.

We have not concealed from ourselves the fact that the reconstruction of Germany is not an end in itself. It is only part of the larger problem of the reconstruction of Europe.

We would point out finally that while our plan does not, as it could not properly, attempt a solution of the whole reparation problem, it foreshadows a settlement extending in its application for a sufficient time to restore confidence, and at the same time is so framed as to facilitate a final and comprehensive agreement as to all the problems of reparation and connected questions as soon as circumstances make this possible.

PART II

I. THE CURRENCY POSITION

The conditions at the outset of our inquiry. When we started our investigations the value of German currency had been stable for some two months. It would not have been pretended, however, by any authority that German currency had been stabilized. It would perhaps be juster to apply the term "unstable equilibrium" than the term "stability" to this transition period, which has fortunately continued to the present day. The elements of permanent stability, even if the repercussions of the budget situation are momentarily left out of account, were then and are still wanting.

One of the first steps which the Committee took was to request Dr. Schacht, the Governor of the Reichsbank and the Currency Commissioner of the Reich, to give evidence before them with a view to their being fully informed of the existing currency situation.

Quantity of currency. The total circulation, although so enormous in nominal values, was, when reduced to its gold equivalent at that date, something over 3 milliard gold marks only, whereas the pre-war circulation in Germany had amounted to 6 milliard gold marks. *Prima facie* therefore the amount of currency seemed deficient rather than excessive, and not likely in itself to be a cause of further depreciation. In proportion as the German mark dwindled in value and became less and less utilizable for the threefold function of standard of value, instrument of payment and medium of saving, foreign currencies naturally became by force of circumstances, more and more sought after in Germany. The Germans resorted increasingly to the currencies of countries with a comparatively stable exchange, not only to invest their savings, but also to define and even settle their transactions, and the presence of such currencies in Germany increased ever more as the mark depreciated further.

In spite of this extended use of foreign currencies in Germany, the shortage of purchasing power made itself increasingly felt, lead-

ing first the German government, then the States and Municipalities, and finally the great industrial and agricultural organizations and even private firms to supplement the currency shortage by new instruments of payment. These token currencies, expressed in gold or paper marks, sprang up in Germany in the summer of 1922, at a moment when the need became urgent to find new means to meet the requirements of current transactions, the old mark on the verge of its collapse no longer answering such requirements.

At the end of 1923 we find in Germany an absolutely heterogeneous monetary circulation, which included—besides the foreign money in circulation or hoarded (dollars, pounds, florins, gulden, Swiss francs, French francs, Scandinavian crowns, etc.)—the old paper marks, Dollar Treasury bonds (*Dollarschatzanweisungen*), bonds of the Gold Loan (*Wertbeständige Anleihe*), 6 per cent Treasury Bonds (6 per cent *Schatzanweisungen*), *Rentenmarks*, and lastly a whole set of odd emergency currencies (*Notgeld*) expressed either in gold or in paper marks.

Backing. The security of the *Rentenmarks* is a mortgage on real and to some extent on personal property. The so-called gold loan is repayable in legal tender on a gold basis but has no gold backing. The various forms of emergency money were for the most part based on no security at all. The gold reserve of the Reichsbank amounted to some 467 milliards, but 200 million thereof was specifically earmarked as security for the dollar loan issued by the Reich in 1923.

Taken as a whole, therefore, the liquid backing of the currency is wholly inadequate for a permanent system.

Interchangeability. The *Rentenmark* is not actually legal currency within the country nor available for any purposes of foreign trade. The old currencies with their vast denominations remain the legal currency, but prices are everywhere expressed in *Rentenmarks*. It is therefore obviously necessary that payments should be made indifferently either in Reichsmarks or in *Rentenmarks* at a fixed relation between them. The Reichsbank accordingly accepts *Rentenmarks* at the rate of one *Rentenmark* for one billion paper marks, and *Rentenmarks* are also accepted in payment of taxes at the same rate.

Annex 7 to the present report shows in some detail the curious monetary situation in Germany at the end of January last.

The present tranquillity. As the Committee have remarked, the elements of currency stability were not to be found in such a situa-

tion. The temporary equilibrium of the German exchange has been ascribed to various causes by different authorities; some lay stress upon psychological factors, and in particular a renewal of confidence, the exact basis of which it would be difficult to determine, but which took account of the efforts being made by the German government to balance its budget, and of the appointment of the Committees of Experts by the Reparation Commission; others refer to a decrease in internal consumption which with the lack of credit, accompanied by what was probably an excessive restriction in importation, reduced the demands both for the circulating medium and for foreign currencies.

Credit facilities. The exportation of the Rentenmark is prohibited. Its existence was of no assistance in the maintenance of foreign trade. The Reichsmark was too discredited to be any longer available for the purpose of meeting foreign obligations. Credit was only obtainable abroad at dangerously high rates of interest.

At the same time, the currency depreciation and its secondary effect had produced a serious dearth of liquid capital in Germany itself. The stringency may be indicated by the fact that (according to figures furnished to us) the savings bank deposits had fallen from 10,700 millions at the end of 1913 to 760 gold marks at the end of 1922; the credit accounts in the eight large Berlin banks amounted to 7,400 millions at the end of 1913, and to about 1,000 millions at the end of 1922. The figures for 1923 are not yet available, but can scarcely exhibit an improvement. Leaving for the moment out of account capital which in one form or another had been exported, liquid capital in monetary forms liable to depreciation had been steadily converted into fixed assets with a permanent intrinsic value. The private individual had purchased consumable commodities, while industrial enterprises had largely extended their plant and equipment. The motor was in good, perhaps in unusually good, condition, but the motive power and lubrication were apparently lacking.

Immobile credit resources. On the other hand, there was general agreement that not inconsiderable resources were available in the shape of German balances abroad and foreign currencies in the pockets of the population in Germany itself. This latter item alone has been estimated at 1.2 milliard gold marks by the Committee appointed to consider the means of estimating the amount of German exported capital. It was reasonable to suppose that a large proportion of these resources would be available if complete

confidence in the stability of German currency could be restored and maintained.

As stated in Part I, the Committee consider that this end can best be secured by the institution under proper safeguards, of a new bank which should absorb the existing currencies, liquidate the Rentenbank and transform the Reichsbank, and provide, against recognized banking cover, the foreign currencies necessary for the revival of Germany's languishing trade. The plan for this bank is given in Annex 1.

Psychological considerations seem imperatively to require an institution which should be so far new in its policy and its administration, as to detach it entirely from the errors of the recent past and restore the older traditions of German banking.

The Interim Bank. While coming to this conclusion and while reducing the general plan to details, the Committee had to deal with an actual change in the situation as it originally presented itself. The Committee were informed that a scheme for a gold bank was in preparation. It was expressly and admittedly limited to providing the means of carrying on foreign trade. When first submitted it contained some features which the Committee would not have recommended, and it omitted others which seemed to the Committee to be essential to any permanent settlement of the problem as a whole. Moreover, an attempt to settle particular difficulties in isolation and without reference to other essential requirements appeared to the Committee to involve certain risks.

The Committee therefore without expressing any opinion on the plan as given to them in outline, assured themselves in consultation with the authorities responsible for Germany's monetary policy that the bank would be so organized as to facilitate its absorption into a new bank of issue which might be set up in accordance with the recommendations of the Committee

II. CONSIDERATIONS REGARDING THE MEASUREMENT OF GERMANY'S BURDEN

a. COMMENSURATE TAXATION

In Part I we refer to the fact that we have taken full account of this principle. But it is necessary for us to make some further observations thereon.

The principle of the "Commensurate Burden," as it has been called, unimpeachable in abstract statement, is exceedingly difficult to translate into quantitative measurement as a basis for practical action. While obviously sound and just, it does not easily admit of precise and arithmetical calculation. What at first sight seems to be a simple conception, on examination is found to be complex and in some respects not reducible to exact definition.

Now the ordinary expenditure which has to be provided for in the German budget is reduced, in part by the restriction upon her military preparations, but above all by the practical extinction of her internal debt.

If Germany had sustained the burden of her own debt, as the Allies have done, and not obliterated it by inflation, she would have had to raise $4\frac{1}{2}$ to 5 milliards per annum in addition to her domestic expenditure.

This would make it both just and practicable to add a provision in her budget which should bear some correspondence to the provision made in the Allies' budgets for their war expenditure.

But the raising of any particular sum from one section of her inhabitants, to be paid back to another section within her borders, is a "burden" in a different sense from the payment of such a sum by the whole population to people abroad—different in more than the economic sense—and it is difficult to bring such a task into direct relation with the problem of reparations. It is a measure of what individual taxpayers, rather than a nation, may be capable of bearing.

In the first case the interest paid forms a part of the national income, as it is expended it provides profits and a stimulus for internal trade and so increases further the income of the country, and in particular it is itself an important source of internal taxation.

A payment in respect of a debt to foreigners has no comparable advantages to the country making it. The extinction of the German debt has after all been at the expense of her own nationals, who are her taxpayers: they have sustained as holders of German bonds, not only the burden which they have already escaped as taxpayers, but that which they would have borne in future years to meet the service of the internal debt if its value had not been destroyed by depreciation. The process of extinction has indeed (except in its incidence as between different individuals and classes) had the same results both to the Treasury and to the German taxpayer regarded collectively with a capital levy devoted to debt extinction.

The loss incurred by individual holders of debt is exactly offset by a corresponding profit accruing to the taxpayers as a whole.

It renders both practicable, and just, a greater charge for other war debts than would otherwise have been possible. A large proportion of the richest taxpayers of the country have obtained the relief without themselves sustaining the cost. They are a proper source of taxation commensurate with that weighing upon the corresponding classes in Allied countries and in particular upon the industrial classes. To them as individual taxpayers a tax is a tax whether its ultimate destination is the payment of a war debt due to fellow-citizens or to foreigners. And under the system we propose it may be regarded as a tax in internal currency without the complications which result from the question of how sums so received can be converted into foreign exchange. For this special problem we provide special safeguards. The German taxpayer should regard a payment in respect of war debt exactly as an allied taxpayer regards a similar payment. Its ultimate destination need not concern him, and is certainly no justification for him to attempt to evade it.

The facts as to the burden actually being borne by the Allies for debt service are perhaps a better approach to the actual problem. If the German burden per head for debt were as onerous as the burden for debt existing upon the inhabitants of Belgium, France, Great Britain and Italy taken together, then the German debt charge would approximate to 6 milliards. But in this case again, the charge is to a considerable extent in the nature of a redistribution of annual wealth among the members of each nation and has little relation to the problem of a national burden in the collective sense.

In the third place, it may be said that if the German people were burdened as heavily as the members of the most heavily taxed of the Allied countries are taxed for all purposes, *excluding debt charge*, we should have an expression of the commensurate burden principle in a limited and strictly defensible sense. But even here, theoretical and practical difficulties prevent exactness.

In the search for the "commensurate" it is not enough to compute the burden as a per capita charge, it must be related to per capita wealth or income; it is considered by many that justice requires a "minimum of subsistence" to be first deducted from such per capita income; the amount of the minimum is not exactly determinable and it seems to vary as between different countries of different

climates, different economic development and different customs, e.g., as between Spain and the United States; it may even vary between different periods in the same country. As a rough working assumption, such a minimum may be regarded as varying in proportion to the per capita income of different countries. Furthermore, over any period of time this burden per head in the Allied countries must change and what might be a valid comparison to-day in taxation in those countries may be quite different in ten years' time. The comparison of statistics of total taxation, national and local, in each country presents many technical difficulties. Moreover, statistics of total national income, and income per head are at present either very defective or wholly lacking. Notwithstanding these difficulties it is possible to compute roughly what total budget charge would be borne by the German people if they were subject to taxation (central and local) on the same scale per unit of income as in Great Britain, and by deducting from the result the necessary domestic expenditure to derive an arithmetical balance which could be, theoretically, at any rate, assigned to the payment of reparation.

Combining these various aspects, we have reached the view that the "commensurate burden" principle for Germany, when she is fully restored to economic prosperity, would more than justify all the practical conclusions we have set down and that they are in every way morally defensible.

There are, of course, good reasons of a political, economic and psychological character for confining the actual requirements of budget accumulation within Germany to limits well below the figure that would be arrived at from the consideration of this principle by itself. Different individuals will differ in the degree of importance they assign to such reasons. It is perhaps unnecessary to state these aspects in detail and sufficient to register our united conviction that all our recommendations and suggestions are well within what can be morally justified on the principle of "commensurate burden," whatever limitations may be placed upon that principle. In this sense, therefore, the justice and moderation of our proposals ought to be fully recognized by the German people themselves.

In the above discussion we have disregarded the question of railway profits. Inasmuch as budget revenue is not derived from profits on railways elsewhere, no question arises as to whether railway profits are a burden (in the sense of a tax). Such profits in other countries form a part of the ordinary profits of private concerns

accruing to individuals and it may be said therefore that in Germany the position of the taxpayer is the same whether such profits go to individuals or to the Allies as reparation.

On the other hand, the German railway profits might go in relief of taxation burdens, if they were not applied to reparations. Moreover it is difficult to say that the abstraction of the profits of so important an undertaking as the railways of a country from that country, instead of leaving them there to be enjoyed individually or collectively by the inhabitants, is not a "burden" in the international sense, even if it is not a part of the individual "*commensurate burden of taxation*."

b. EXPORT STATISTICS AS AN INDEX OF PROSPERITY

In Part I we have suggested an index of prosperity and indicated that in our opinion it was a fairer test than the existing index, namely, export statistics. The use of the latter in isolation has certain definite defects, to some of which we desire to draw attention.

(1) Foreign trade only covers part of the area of total trade, and if foreign trade at a given moment only covers a small part of the area, total trade may be moving in a direction opposed to that of foreign trade.

(2) Artificial conditions, such as alterations in transport charges, may affect the trade figure in the absence of any real change in the value or volume of exports.

(3) The export statistics, more especially when no export duty is in force, may be subject to changes in presentation, and frequently furnish material for controversy.

(4) Reparation payments themselves are, and can only be financed by an excess of exports. It follows that an increased reparation payment in one year furnishes an increased base for the following year. This process is cumulative and the basis for the index is continuously raised, so to speak, at compound interest, even though actual prosperity may be stationary.

(5) In a country with an economic life such as that of Germany, invisible exports may increase more rapidly than physical exports, and there may be a growing prosperity which is not reflected in export statistics.

C. MEASUREMENT BY YIELD OF PARTICULAR TAXES

We have laid some stress in Part I on the fact that certain revenues were chosen strictly as guarantees and that fluctuations in their yield were not to be regarded (save in 1926-27 and 1927-28 exceptionally) as determining the payments due by Germany. The following are the broad principles justifying this standpoint.

1. It is desirable that the German government and the German people should be themselves interested in increasing the yield of the controlled revenues, and should be under no temptation to discriminate against these taxes in favor of others.

2. The year's liability which, under our plan will include an allowance for increased prosperity, will already have been established by one test, in which moreover the yield of the controlled revenues indirectly forms one element. Having applied one test, it would be unfair to apply a second, and to choose whichever gives the higher result.

3. The year's liability ought not to vary with the fortuitous yield of particular taxes. The character and level of these taxes should be chosen with a view to their suitability as security and not with a view to their appropriateness for fixing obligations.

Unless the liability of the year is definitely fixed and unless the German government can proceed to estimate its resources by reference to the whole and not part of the taxable field, the difficulties of forming a satisfactory budget are aggravated, and German credit is affected.

4. Common sense requires that the reparation liability ought not to rest even indirectly upon the rate of particular taxes, or otherwise every change in rates or methods of collection, even when thoroughly justified by social or political reasons, must be scrutinized with such a degree of care and perhaps suspicion that it becomes a fruitful source of friction and dispute.

III. THE GERMAN BUDGET FOR 1924-25, AND THE FISCAL SYSTEM

The 1924-25 budget. The German government prepared and submitted to us the outline of a provisional budget for 1924-25 which estimates a small excess of receipts over the ordinary administrative charges of the country. (Annex 8.)

While the Committee have spent a great deal of time upon the de-

tails of this budget, and have put many questions in writing to the government and in oral cross-examination of the officials upon its chief features, the subject is so vast in its ultimate implications, especially having regard to the constitution of the Reich, that no finality could possibly be reached, especially in a matter which to the Germans themselves is full of difficulty and doubt. Nevertheless we believe that the ground has been explored to a sufficient extent to justify us in feeling that even a prolonged examination could not substantially alter our conclusions. To some of the more salient points we shall make particular reference.

The conditions under which the budget estimates were made. It should, however, be first remarked that in general the budget must necessarily be in the nature of an experiment and the individual items in it somewhat arbitrary estimates. At the time of our investigation Germany was passing through an acute economic crisis, the direct result and the culminating point of a depreciation of the currency so catastrophic as practically to destroy the currency and reduce the budget to all but a shadow. The habit of saving has been destroyed, and it will require time and the restoration of confidence to re-establish it. The existing wealth is maldistributed in an almost unparalleled degree. The cessation of depreciation, with the consequent removal of the premium on export and the stabilization of prices at a level which is momentarily at any rate above that of the world level, has had important reactions. Finally the state of employment and the fiscal and economic machinery of Germany have been violently deranged by the events of 1923; a return to normal conditions in this respect can not be effected overnight.

Assumption underlying the budget. It should be most carefully noted that the budget is not made up to represent the financial expectations of actual existing conditions. As we have remarked above, the general budget as presented anticipates a credit balance, and the German Finance Minister appeared to be reasonably confident of his ability to live up to these estimates, provided three essential conditions were fulfilled:

1. That the Bank of Issue which would serve as a basis for the grant of credits would be established;
2. That the full development of German economic life should not be restricted by the severance of the Ruhr and the Rhineland;
3. That Germany enjoyed complete freedom in her economic relations with other countries.

The first and second of these conditions will be fulfilled if our recommendations are accepted, and they appear to us to be essential to budget equilibrium. As regards the third, we understand that Germany's commercial freedom is restored under the terms of the Treaty in less than twelve months' time.

We are not, however, satisfied that the budget as framed is not exposed to a real risk of deficit. The German fiscal year begins on the 1st of April and even if our recommendations are accepted a certain lapse of time will be necessary before an absolutely normal administrative situation can be re-established.

For this, if for no other reason, we conclude that on the existing basis of taxation the estimated revenue may not be realized, even allowing for certain possible underestimates under particular headings.

On the expenditure side, the only item on which a saving may emerge of any great significance relatively to the possible deficit is the provision of relief for unemployed. The sum allocated to this purpose (500 million gold marks) is estimated on the assumption that the existing amount of unemployment will continue throughout the year. It appears to us that this is unduly pessimistic and any reduction in the number will both relieve the expenditure and the revenue side of the budget, inasmuch as the wages earned by a laborer are subject to direct, and through the medium of his expenditure, to indirect, taxation.

Taking one item with another, however, we can not justifiably state that the results are likely to be any better than have been indicated in their estimate. But if, for this year, 1924, there was a deficit (we have just seen that this possibility can not be absolutely disregarded) we can assert that it would not be of an extent to endanger the stability of the currency, or force the German government to have recourse to other than the conventionally authorized expedients for meeting it, such as increases of existing taxation, further emergency taxes, or small internal loans.

Moreover, so many of the settlements due in the year 1924 will fall to be made in the year 1925-26, that fiscally these two years tend to be merged into one period and, as will be seen later, we have no doubt that in that period ordinary budget receipts will fully equal ordinary budget expenditure.

Special features in the fiscal system. The income tax. We do not propose to comment in any detail on the existing taxes, but there are certain broad features which call for notice.

We have been unable to escape the conclusion that the wealthier classes of Germany have, in recent years, not been reached properly by the system of taxation in force, either to an extent which the taxation of the working classes would justify, or to an extent comparable with the burden upon the wealthier classes in other countries.

It is, of course, common knowledge that, with a continually depreciating currency, many classes of business men tend to obtain as profit a larger share than is normal of the total produce of industry. Many of their expenses are in the nature of fixed charges; moreover, generally speaking, paper-mark wages have not advanced as rapidly as paper-mark prices have increased, so that the share of the business proprietor in the total produce of industry, altogether apart from the special profits made by him on redeeming debentures or mortgages at nominal figures, has tended to be greater than is normal.

Direct taxes, such as income tax, are necessarily assessed for completed periods and during a time of rapidly rising prices the burden of any particular year, based on the profits of previous years, is small relatively to the profits of the year itself. Moreover, the process of return, assessment and appeal for such a tax necessarily occupies further time and by the date when substantive liability is fixed in paper marks its real burden is far less than was originally intended. Further delay in payment of that liability intensifies this effect. It was not until the inflation movement was well advanced in Germany that any serious effort was made to combat this evil. Although the rates of income tax according to the nominal scales rose to nearly 60 per cent on the highest incomes, statistics of cases furnished to us by the German government show that in effect, even in the year 1920, the burden of actual tax (measured in gold) on the higher incomes, instead of being 50 to 60 per cent, was only half those rates upon the income of the year (measured in gold). This was undoubtedly one of the primary causes for the budgetary difficulties of Germany, and the disparity was very much greater in the later periods. It can be said with confidence that the wealthier classes have escaped with far less than their proper share of the national burden and we have put it as a matter for the serious consideration of the German government whether they should not, facing even the admitted administrative difficulties, review the assessments of recent years in the case of these particular classes of taxpayer and reassess their liability upon a gold basis.

The whole system of direct taxation went to pieces in 1923 and,

for 1924, the income tax, as is easily understood, is in abeyance. The profits of industry in 1923 expressed in nominal figures of paper marks have no meaning unless they can be resolved into the profits of the particular dates on which they were made and then reduced to a common denominator of gold values. A profit of 1,000 marks made in January, 1923, is obviously quite a different amount from 1,000 marks made in September. We can well believe the German government finds it impossible to use the year 1923 as a basis for income tax assessment in 1924.

They have been driven to temporary expedients of a very makeshift character, not rising to a higher normal burden than 25 per cent, with the intention of rescheming and reassessing the income tax proper in 1925.

These expedients do not reassure us upon the general question as to the taxation of the wealthy classes, and, in our judgment, if they desire the Allies and their own working classes to realize their good faith in this matter, the German government should publish at an early date their definite intentions with regard to the scales of income taxation that are to be applied during 1925-26 to the actual profits of 1924-25 for the final adjustment of the fiscal year 1924-25.

The 1924-25 budget estimates 1,344 million gold marks as the income tax yield, of which all but 480 million gold marks is estimated to be assessed on wages.

We have drawn the German government's attention to the absence in the temporary measures of any proper provision at present for dealing with income from abroad. They were asked to furnish us with details of the comparative position of different incomes drawn from dividends in the years 1920-21, 1923-24 and 1924-25. The reply is given in Annex 9 as indicating the present position of direct taxation in Germany.

Special taxation on those who have specially profited by depreciation of currency. Currency depreciation, on the scale it has occurred in Germany, has brought into existence a new and special type of "windfall" wealth which is a suitable subject for taxation in an emergency.

The ultimate profit or loss to industry and agriculture as a whole of the depreciation era may be difficult to calculate. There are many cases, however, of industrial and other undertakings which were not only able to make large profits, but succeeded in paying off prior charges at a trifling fraction of their value when incurred.

If a mortgage or debenture of 10,000 marks has been paid off for

practically nothing, a "windfall" profit to the debtor (at the expense of the impoverished creditor) has been made to that extent. If it has not yet been paid off, but the debt can in due course be discharged by worthless paper marks, the "windfall" is a potential one. In this last case, it has been decided by the German government to "valorize" the debt at 15 per cent and the windfall to the creditor is to be restricted to 85 per cent. On this remarkable improvement in his position, the government proposes to levy a tax of 2 per cent, or 1.7 on the whole debt. In the case where the debt has been paid off, the government will take the actual difference between the gold price paid and 16.7 per cent. In our view, such special taxation, if justified in principle at all, as we believe it to be, is justified at much higher rates. But certain rights of taxation are being given to the Federal States which encroach upon this area of taxation, and, for the rest, our proposals (Section IX, C. of Part I) in regard to industrial debentures cover what might otherwise have been independent recommendations under the head of taxation.

Similar extraordinary profits have been made through State subventions, and through the repayment in depreciated currency of bank loans, State advances, and other similar obligations.

The Reich and the States. The third special feature to which we would refer is the financial relation between the Reich and the States and Communes.

The more complete financial centralization that took place after the war in accordance with the Weimar Constitution has not fundamentally changed the character of the relations between the Reich and the States. Although the Reich is charged with the administration of taxes formerly undertaken by the States, it is under obligation to cede the major part of the proceeds of the income tax, for example, to them. The States discharge wholly or in part many of the functions of government, and there is no clear principle connecting their resources with their obligations. When in difficulties, they press the Reich for larger subventions (as percentage of the yield of taxation) just as in turn the needy Communes press the States for greater financial aid.

The situation has hitherto been governed by merely political or administrative opportunism rather than by clear financial principle. The Reich can either yield to the pressure for higher percentages in subvention or they can confer upon the States the right to exploit particular fields of taxation for themselves. The check by the States upon the Communes is equally unsatisfactory. It is almost

impossible to ascertain the true cost of any of the single functions of government in view of its division between these three constitutional entities, and in the absence of proper, aggregated financial statistics of the States and still more of the Communes.

The changes that have taken place completely falsify any comparison which could be established between the pre-war Reich budget and that for 1924-25.

Moreover, these relations are once more under review. During the period of rapid depreciation, the resources of the States and Communes, together with the regular allocations from the revenues of the Reich, were inadequate to their needs. Their financial situation was similar to that of the Reich itself.

The expedient adopted by the Reich of multiplying the issue of notes was not open to the States and Communes, who had necessarily to be supplied with continuously increased subsidies from the Reich, and this proceeding was one of the principal causes of the utter breakdown of the German finances.

The resultant chaos has been such that no up-to-date statistics are available, and the States have not yet framed their budgets on a gold basis. It is in our opinion essential that at the earliest possible moment the preparation of complete statistics of the receipts and expenditures of the States and Communes should be resumed.

The importance of the question may be seen if it is realized that the Reich budget, after allowing for the subsidies, contains little more than one-third of the total expenditure, one-third being met by the States and one-third by the Communes. It would be quite possible for the Communal budgets to be enjoying considerable prosperity at the same time that the Reich budget is in serious difficulties.

We do not pretend to be in a position to make detailed recommendations; the subject is a complicated one and involves the consideration of social and political factors, many of which have deep roots in historic traditions.

Moreover, if our recommendations are accepted in their entirety, self-interest alone may almost confidently be relied upon to force the German government to make provident arrangements with the States, and it has already given us an assurance that the régime of increased subsidies has come to an end and will not be revived.

It is clear, however, that in the near future the German government must take steps to put the relations between the Reich and its component parts on a regular basis which shall ensure that the

latter are not a constant drain upon federal resources; the existing hole in the budget must be plugged.

It does not suffice, in our judgment, for the Reich to remain in supine contentment with the present situation merely because it has been the result of constitutional evolution. Germany waged war as an undivided whole and the financial responsibility of the Reich to the Allies can not be qualified or weakened by an attitude of passive acquiescence in the undiminished rights of subordinate areas. So long as Germany has any external obligations they must be paramount, and the resources normally to be assigned to the States and Communes must be clearly defined, and care must be taken to secure that these resources are not more than adequate to legitimate needs.

Where further assistance must be given by the Federal Treasury the amount of such assistance should again be strictly proportioned to the necessities of each case, and subordinated to continually increasing central supervision by the Federal Treasury of local expenditure.

In considering the budget as drafted in 1924-25 we have felt compelled to assume that the assignment to the States amounting to 1,800 million gold marks is an irreducible figure, and that if the States themselves have budgeted for the receipt of this sum the Reich will be unable to escape the liability in one form or another. This is the most probable assumption which we can make in a matter which bristles with political difficulties, and it is supported by the estimates submitted to us of the Revenue and Expenditure in 1924-25 of Prussia, Saxony and Bavaria: in each case deficits are disclosed.

FURTHER COMMENTS UPON PARTICULAR TAXES

1. The Committee recognize that the taxation of each large nation today is the product of many factors, including its historical evolution, its economic conditions, its political ideas, its constitutional framework, and its social psychology. What is a good system for one country may be quite unacceptable for another. Even though the same elements may exist in two systems, the importance played by those several elements in the whole may be quite different. If a similar total burden is being raised in two countries, it is almost certain that the manner in which it is being spread over the com-

munity and the particular devices adopted to raise it will be very different.

2. For these and other similar reasons we do not regard it as particularly profitable to pass the German budget in detailed review merely to suggest that each particular tax can be raised to a rate or level found in some Allied country for that tax, and thus to impose upon Germany the maximum burden borne under each head in any of the creditor countries. To do this would be to lose sight of the principle we have referred to above, and also to ignore the question of the total burden. For example, to state that Germany could stand increases in the rates on tobacco, beer, spirits, etc., to the level of those in England, while ignoring the existence of her high turnover tax, which England does not impose; or to state that Germany could bear increased rates of death duties, while wholly ignoring the existence of her capital taxes, would be to destroy the balance of her system and be oblivious to the total burden thus accumulated. The Committee would desire to avoid being dogmatic as to the way in which a given sum shall be raised by the German government. Having come to the conclusion that a given burden can be borne, it is for Germany to suit her own conditions in prescribing the ways in which it shall be obtained. At the same time, diverse as the systems in the Allied countries themselves are, the Committee offer the following suggestions as the subject of their common agreement and as suited, in their judgment, to German conditions.

TOBACCO

Eminent technical experts have made the following suggestions, which we commend to the notice of the German government:¹

While they believe that the institution of a tobacco monopoly would entail heavy immediate expenditure, thus causing economic disorder, the technical experts recommend that the free manufacture and sale of tobacco should only be allowed to continue if subject to the regulations of the following scheme:

1. No factory, nor wholesale or retail tobacco shop may in future be established nor may any existing establishment be enlarged without the permission of the State.

¹ These suggestions are contained in a report drawn up by M. Mayer and M. Aliprandi, which will be put at the disposal of the Reparation Commission, together with a report on indirect taxes drawn up by M. Hulin and M. Mazzucchelli.

2. The introduction of tobacco substitutes in manufacture is prohibited.

3. The number of existing factories must be reduced by abolishing, with a fair indemnity, those which are really not industrial in character, while all factories which have been proved by experience to be incapable of producing goods at a fair cost price must be expropriated.

4. Products manufactured in the various factories shall still be sold with their trade mark, while the sale price to the consumer shall be indicated on each package; each box or packet to be sealed with a band representing the State guarantees.

5. Existing manufacturers shall form a consortium according to the category of goods produced. This consortium, while collectively undertaking to supply the State with the quantities required for consumption shall have to deliver its products at its own expense and exclusively to the State warehouses indicated.

6. The products manufactured shall be bought by the State at a price to be fixed at regular intervals.

7. Prices shall be fixed in conformity with the results obtained in one or two State factories, to be run for experimental purposes and for the control of prices.

8. Importers of foreign manufactured products shall be free to continue their business on the sole condition that they sell the imported products to the State warehouses, under the same conditions of delivery as home manufacturers who deliver the goods produced in their factories.

In regard to sale organization, the technical experts make the following recommendations:

1. The State shall use the wholesale dealers' warehouses for its own purposes.

2. Retail sales must be carried out exclusively by licensed retail dealers.

3. The retail dealers must only sell State products bearing the proper guarantee band, at the price fixed on the package.

4. The remuneration of retail dealers shall be fixed at regular intervals by a certain rate of commission on the sale price to the consumer, such rate not to exceed an average of 12 per cent. Bonuses within this limit of 12 per cent would encourage the most energetic retail dealers and thus develop the turnover.

5. Payment for manufactured products delivered to retail dealers shall be made to the warehouse supplying them by means of cheque

or postal order (not in cash and without credit) minus the commission above stated.

6. A small number of State retail shops shall be instituted, in order to obtain reliable estimates and to control the expenses of sale.

On the basis of this plan, the technical experts make the following estimate of the profit to be obtained by the State.

	Swiss francs
Cost of manufacture.....	476,160,000
Manufacturer's profit and additional general expenses (35 per cent of the cost of manufacture).....	166,656,000
Expenses for the warehouse service and general expenses of the sale organization (1 per cent of the gross receipts).....	20,906,400
Cost of delivery to retailers (12 per cent of the gross receipts).....	230,876,800
Additional expenses for transport (80,000 tons $\times$ average distance of 25 km. $\times$ 0.25 fr).....	500,000
Annuity payment in the event of the indemnification of one-fourth of the present manufacturers.....	16,975,000
Total expenses.....	912,074,200
Gross receipts (according to Tables V and VI).....	2,090,640,000
Net profit for the State.....	1,178,565,800
That is.....	856,515,000 g. m.
Percentage of net profit.....	56.4

The technical experts have the following observations to make on the above table:

1. An annuity payment is provided for, which would correspond to the amounts to be allowed for the indemnification of the small factories to be closed down.

2. The cost prices of a free industry distributed amongst a large number of factories are higher than those of a monopoly. Consequently, the costs of manufacture under a monopoly system are

increased by 35 per cent in order to allow the manufacturer a reasonable profit.

3. With this organization, which leaves the factories and retail establishments in their present form, the taxes now collected by the German government would no longer have to be deducted, with the sole exception of the tax on wholesale dealers to the amount of 6 millions.

Under a system of sale, organized in conformity with this scheme the technical experts put forward the results of such a plan as under:

	Gold marks
Gross receipts (amount expended by consumers).....	1,523,960,000
Profit obtained by the State from which must be deducted the taxes at present collected by the Reich.....	856,515,000
Customs tax on turnover.....	6,000,000
Net profit obtained by the State.....	850,515,000

The technical experts consider that it would be preferable to entrust the sale organization to an entirely autonomous organization, the constitution of which might well be based on the example of the Swedish monopoly. On the other hand, it is their opinion that the present fiscal organization of the German Reich should be used for the supervision of the tax.

In conclusion, the technical experts believe that during the first period, which would not exceed two years, the estimate of the guaranteed net profit might be based on the assumption that each inhabitant spends only 26 Swiss francs per annum, which is the figure now obtaining in Austria. Such a figure would yield a net profit of 657 millions of gold marks, on the following estimate.

	Swiss francs
Gross receipts 26×62 millions.....	1,612,000,000
Total expenditure ¹	707,917,000
Net profit.....	904,082,000

or 657 million gold marks.

To recapitulate, the guaranteed revenues for the payment of reparation which Germany might obtain by the tobacco tax would be as follows:

¹ Expenditure shown in the table on the previous page reduced 33.72 with the exception of the expropriation annuity.

	Gold marks (German estimate)
1924-25.....	498,000,000
1925-26.....	657,000,000
1926-27.....	657,000,000
1927-28.....	856,000,000

A considerably larger sum can be realized from the German duties, while decreasing the burden falling on the German consumer. The less efficient factories will be eliminated and substitutes will be abolished; surplus profits of the intermediaries will be reduced, leaving them nevertheless a reasonable margin. Without introducing the monopoly reform, standard factories will be instituted (one or two factories to control costs and few selling shops), and the sales will be strictly disciplined.

The proceeds would be paid in periodically by the "Service of Assigned Revenues," either:

a. In the case of the adoption of the "assiette" suggested by the technical experts, on the basis of 60 per cent of the gross revenue (as the technical experts themselves have calculated that 40 per cent represents purchase price of manufactured tobacco, plus cost of distribution, etc., the remaining 60 per cent represents an absolutely net profit from the duty); or,

b. Otherwise, on the basis of a sum in gold marks for every kilogramme of tobacco taxed, according to the various chief qualities of the tobacco; this sum to be fixed by the technical experts.

2. INDIRECT TAXES GENERALLY

The rates appear to the Committee to be unduly low, and, as prosperity grows, to be susceptible of increase without diminishing consumption.

3. TURNOVER TAX

It is our general opinion that this tax should at the earliest possible moment be somewhat reduced in favor of other forms of taxation.

4. TAXES ON MOTOR TRANSPORT

It is considered that the present total burden is too low and that a substantial further sum might be raised without detriment either by a tax on petrol or a supplementary duty on motor cars, or by a combination of these means.

5. DEATH DUTIES

The yield from these duties is extraordinarily low judged by almost any standard. It is not satisfactorily accounted for by the temporary depreciation in capital values which is due to lack of profits and trade output. Not only is the total yield low judged by any test as to capital values, but the actual rates of duty being imposed are also, in the Committee's judgment, inadequate. While not unmindful of the effect of the relation between these duties and the capital tax in general, the Committee thinks that the position disclosed in the following table, compiled by the German govern-

FISCAL BURDEN CONSTITUTED BY THE DEATH DUTIES IN GERMANY,
BELGIUM, GREAT BRITAIN AND FRANCE

(Burden expressed in percentage)

Property left (in gold marks)	Germany	Belgium	Great Britain	France
<i>Wife and three children</i>				
20,000.....	1.5	2.1	3.0	3.5
200,000.....	2.9	2.7	5.0	6.1
2,000,000.....	5.9	3.8	15.9	11.5
6,000,000.....	7.5	4.8	22.8	14.4
<i>Brother</i>				
20,000.....	7.8	8.3	3.0	23.3
200,000.....	17.4	11.4	5.0	36.0
2,000,000.....	30.0	17.0	19.2	50.1
6,000,000.....	30.0	22.2	25.9	56.2
<i>Person next of kin</i>				
20,000.....	18.2	16.7	3.0	36.8
200,000.....	40.6	22.8	5.0	48.3
2,000,000.....	70.0	34.8	23.5	61.0
6,000,000.....	70.0	44.5	29.8	66.5

^a The foreign currency has been converted into gold marks on the basis of the average rates of exchange quoted for the currency at issue on the Berlin Stock Exchange in the month of January, 1924. According to these quotations 1,000 gold marks were equivalent to:

55.5 pounds sterling in round numbers, or
5,000 French francs in round numbers, or
5,550 Belgian francs in round numbers.

ment, indicates that there is considerable room for increased taxation under this head. It will be observed that where the rate in Germany is nominally higher than that in other countries, it is in those scales where the tax may be least influential in its effect upon total yield.

Annual taxation on capital, in the Committee's judgment, tends to become a part of the income tax system and to discriminate between income derived from work and that derived from investment. In this case, therefore, taxation of capital by annual payments is in a different category from ordinary succession duties.

IV. PROPOSAL FOR CONTROL OF REVENUES ASSIGNED AS SECURITY

It is necessary to elaborate in rather fuller detail the recommendations which we have made in Part I of this report for the assignment of the taxes, etc., on tobacco, alcohol, sugar, beer and of the customs revenue as security for payment of the sums charged annually on the German budget.

As regards the years 1926-27, 1927-28, as already indicated, the assigned revenues will play a special part in our plan. They will not only serve as a guarantee to creditors, but also as a means of measuring the contingent addition to, or deduction from, the total amount of reparation payments laid down in the plan. If the yield of these revenues falls short of 1 milliard in 1926-27 or $1\frac{1}{4}$ milliards in 1927-28, the reparation payments will be diminished by an amount equal to one-third of such deficiency; on the other hand, if they exceed those limits, there will be an additional payment equal to one-third of the excess; both deduction and addition, however, are limited to an amount of 250 millions in each year.

In 1928-29, and subsequent years, the amount of Germany's obligation is fixed by the standard payment, plus supplementary payment (and into the computation of the latter, the increased consumption of these taxed articles will enter).

The total yield of the controlled revenues will be paid into the account of the agent for reparation payments as from the time when the plan is put into execution.

In the first year in which there is a charge on the budget and in all subsequent years, the amounts required to meet the charge will be retained and the balance will be periodically released to the German government.

We propose that there should be one Commissioner to supervise the controlled revenues and under him a sub-Commissioner for each of the five controlled revenues.

In order that the Reparation Commission may be in a position to secure an officer of the greatest experience and efficiency as Chief Commissioner, the area of selection should be as wide as possible and not confined to the Allied countries.

He should have the assistance of a consultative and advisory committee on which each of the interested Allied countries would be represented.

The various German services of the assigned revenues would be obliged to deposit, through the receiving offices, immediately on receipt, the amount received under the head of the revenues in question at the nearest branch of the Central Bank acting as treasurer.

A. *Funds.* The separate branches should pay the sums into the Central Bank to an account at the disposal of the Commissioner, who should afterwards provide for the periodical "reversements" to the German government of sums in excess of the proportion of the Peace Treaty payments accrued to date.

B. *Audit.* The Commissioner would impose such methods of independent audit as he might desire to ascertain that all assigned revenues:

1. Were properly obtained from the public, and
2. Flowed through the control administration.

C. *Detailed responsibility for management.* He would not be obliged to assume responsibility for detailed administration except in the case and in the manner indicated below. It would be his duty to see at all times that the administration was reasonably efficient and the accounting system honest and accurate. But since the interests of the Allies are not affected so long as the revenues are sufficient, with an adequate margin, to meet the annual charges, it would not be his duty in such circumstances to interfere with the details of Control.

He would therefore not normally be obliged to insist on the exact tariffs or the exact form of administration which would, in his view, secure the utmost yield, and he would not therefore be obliged (unless the need arose) to assume the responsibility of detailed direction with the administrative expense on staff, etc., which that would involve nor would he be required to have such an elaborate and expensive accounting and calculating personnel as would enable him to certify that every mark was accurately accounted for (which

is obviously a very different thing from seeing that the system is honest and efficient).

If the need arose his control would become automatically more active, more responsible, more difficult and, of necessity, more expensive. For if the revenues were in danger of being insufficient, it would be his duty to take every possible measure to increase their productivity. This increase in the active character of the Control would be in exact proportion to the need for it. He would thus reform and direct administration in detail only if and so far as necessary.

D. *The technical control* would consist, in the ordinary course of the right:

- a. To obtain all information and examine all books;
- b. To visit and inspect the factories subject to duties, and to ascertain that approved standards are maintained;
- c. To send experts to report and advise and, in case of actual necessity arising, to exercise detailed control;
- d. To propose higher technical standards;
- e. To require prior advice of all administrative regulations.

In settling the constitution of the Control Body it should be borne in mind that it may be concerned with the issue of bonds guaranteed by the said assigned revenues, if it is desired to create an international bond other than the railway one.

The German government should be asked not to reduce the rate of the assigned revenues without the consent of the Commissioner, which would not be given until the consultative committee had had an opportunity of considering the proposal and approved it by a majority; on the other hand, it is considered necessary that the German government should be encouraged, regard being had to the rates prevailing in other countries, to effect increases in the taxation of alcohol, beer and sugar.

The above system makes it unnecessary in relation to the problem of security to insist on an increase in any particular tax, though we suggest to the German government that it is to their interest, especially having regard to the rates prevailing in other countries to effect increases in the taxation of alcohol, beer and sugar. But all interference in the German government's tariff policy is to be avoided.

To sum up this subject we would lay down the following general principles:

1. The main lines on which the Control should work ought to be

decided by the countries interested. These main lines establishing the principle of a control developing automatically as required, and becoming complete control as soon as the revenues appeared to be insufficient, should therefore be laid down in protocols signed by all the countries whose interests are mainly involved.

2. These main lines should be elaborated into detailed instructions by international experts (in practice, of the nationalities of the countries interested).

3. With this safeguard, the execution of the Control is entrusted to a single impartial person (with the necessary staff) so as to secure the rapid and consistent administrative decisions required for an efficient Control.

4. His responsibility to the Reparation Commission should not be of a day-to-day order, but a periodical report should be made by him upon the condition and yield of the gage revenues.

5. In the event of the revenues for a given year proving insufficient, the whole system outlined in this scheme (working of the railways, a mortgage on industrial property, the control of the revenues assigned as security) will be prolonged as required for the purpose of making good the deficit.

The Committee desires to express its higher appreciation of the valuable and efficient cooperation received throughout its task from the General Secretary, Mr. Andrew McFadyean, and to thank his assistant, Monsieur Denis, the interpreters, and all the staff for their ungrudging services.

PARIS,

April 9, 1924.

CHARLES G. DAWES, *Chairman.*

OWEN D. YOUNG.

ROBERT M. KINDERSLEY.

J. C. STAMP.

J. PARMENTIER.

EDGARD ALLIX.

ALBERTO PIRELLI.

FEDERICO FLORA.

E. FRANQUI.

MAURICE HOUTART.

PART III

ANNEX No. 1

TO THE REPORT OF THE FIRST COMMITTEE OF EXPERTS

PLAN FOR THE ORGANIZATION OF A BANK OF ISSUE IN GERMANY

I. NAME AND LOCATION

The Bank, hereinafter designated as the "New Bank," shall bear a new and suitable title, unless, in conformity with paragraph (b), Section III below, the Organization Committee shall decide to use the Reichsbank for putting the present plan into operation. It shall be a private corporation, and its charter shall be for fifty (50) years. The new Bank shall have its principal office in Berlin and such branches and agencies as its Managing Board shall determine.

II. CAPITAL

a. The Bank shall have a cash paid-up capital of four hundred million (400,000,000) gold marks, which shall be in registered or bearer shares of one hundred (100) marks each. These shares shall be issued as follows:

1. One million shares to represent the assets of the Reichsbank;
2. Three million shares for subscription in Germany and abroad.

b. All shares shall be alike, and after the initial subscriptions have been accepted, no restriction shall be imposed upon their purchase and sale, other than such general restrictions of German law as shall apply to the purchase and sale of shares of other banks.

c. Shares whether sold in Germany or abroad shall be paid for entirely in gold, and/or foreign bills, at their current gold values.

d. Subject to the preceding provision of this section, the shares of the new Bank shall be allotted and sold on such terms as to prices, times of payment and other conditions, as are most advantageous to the Bank.

III. ORGANIZATION COMMITTEE

a. For the purpose of taking the preliminary steps for the Bank's corporate organization there shall be created a temporary committee, to be known as "The Organization Committee." This Committee shall consist of two (2) members, the President of the Reichsbank, and one (1) person who shall have been a member of one of the Committees of Experts acquainted with the discussions which resulted in the drafting of the plan for the Bank.

b. The Organization Committee shall have power generally to interpret any ambiguities appearing in the plan, provided always such interpretation shall not interfere with the principles involved. It shall also have power if it deems wise to carry out this plan by the transformation of the Reichsbank, under suitable legislation, rather than by the organization of a new corporation. It shall frame the statutes regulating the administration of the Bank. These statutes shall in particular include provisions concerning:

1. The form and character of the share certificates of the Bank;
2. The formalities to be fulfilled for the transfer and pledging of the registered share certificates;
3. The cancellation of share certificates lost or destroyed;
4. The method by which the German shareholders shall elect the German members of the General Board;
5. The nature of the reports published by the Bank, as well as the method and place of their publication;
6. The nature and duties of the permanent committees, of the Managing Board and the officials of the Bank;
7. The administrative departments to be created within the Bank;
8. The date and place of the regular meetings of the Managing Board and of the General Board;
9. The special meetings of the Managing Board and of the General Board.

IV. ADMINISTRATION AND MANAGEMENT

The Bank shall be administered by a Managing Board, under the chairmanship of a President, all of whom shall be of German nationality.

V. THE PRESIDENT OF THE BANK

a. For the purpose of this memorandum only the Chairman of the Managing Board and of the General Board is hereinafter called "The President"; he shall be the managing director of the Bank. Subject to the limitations imposed by law, he shall perform such duties as are assigned to him by the Bank's statutes.

b. The President may be elected from among the members of the General Board, or chosen from outside the Board. The election by the Board of a non-member, as President, shall operate to vacate automatically the seat of that German member of the General Board having a term of two (2) years or more yet to run, whose election was obtained by the smallest share vote, unless some other member of the General Board, having a two (2) years' term or more yet to run, shall resign at the time, and his resignation be accepted by the Board. A President, elected from outside the General Board shall, by the fact of his election, become a member of the Board.

c. The first President shall be the President of the Reichsbank; his term of office shall be six months. Subsequently, the President, who must be of German nationality, shall be appointed by a majority vote of not less than nine (9) members of the General Board, of which majority at least six (6) votes shall be the votes of German members; this appointment shall be countersigned by the President of the Reich.

d. The President shall direct the Managing Board and shall take the chair at its meetings. In case of a tie vote he shall have the casting vote. He shall appoint the officials of the Bank on the recommendation of the Managing Board. He shall organize the distribution of their work and duties in the Bank, and shall exercise disciplinary powers over the officials and employees, these powers being provided for in a special clause of the statutes to be approved by the General Board.

VI. THE MANAGING BOARD

a. The administration of the Bank shall be entrusted to a Managing Board which shall be the administrative and executive body. This Board shall be under the chairmanship of the President. It shall adopt its decisions by majority vote and in conformity with the regulations laid down in the statutes and by law. In particular it shall direct the currency, discount, and credit policy of the Bank.

It shall fix the rates of interest and shall draft all regulations concerning the policy of the Bank.

b. The members of the Managing Board shall be appointed by the President for a period to be fixed by the Organization Committee, subject to the approval of the General Board, whose decision in this connection shall be adopted by a majority of nine (9) votes, at least six (6) of which shall be given by the German members; these appointments shall be countersigned by the President of the Reich.

c. The members of the Managing Board shall occupy no other remunerated post, neither shall they accept any honorary post without the previous consent of the General Board.

d. The salaries and pensions of the members of the Managing Board and of the President shall be fixed by the General Board, the salaries and pensions of the senior staff of the Bank shall be fixed by the Managing Board with the approval of the President, and in case of the junior staff, by the Managing Board alone.

e. The Managing Board may, if they think fit, obtain the assistance of a consultative body composed of German members chosen from agriculture, commerce and industry.

VII. GENERAL BOARD

a. There shall be created a General Board, consisting of fourteen (14) members hereinafter called "the Members of the General Board." One-half ($\frac{1}{2}$) of these members shall be of foreign and the other half ($\frac{1}{2}$) of German nationality.

b. Each member of the General Board shall be chosen for a period of three (3) years, except in the case of the first election or appointment. In the case of the first term of office, three (3) German members and three (3) foreign members shall serve for a term of one (1) year; two (2) German members and two (2) foreign members shall serve for a term of two (2) years, and two (2) German members and two (2) foreign members shall serve for a term of three (3) years. At the first meeting of the General Board chosen, the members shall decide, by lot, the term for which each shall serve, namely, one, two, or three years.

c. Subject to the provisions of paragraph (b) of this section, and to the provisions of this plan that apply to all members of the General Board, members of German nationality shall be chosen in such a manner and under such conditions as the stockholders of

German nationality shall decide, in accordance with German law. The manner and conditions so decided upon shall be incorporated in the statutes. The manner of selecting the first group of German members shall be determined by the Organization Committee as provided for in Section III of this plan. No plan shall be adopted for the first selection of German members that does not meet with the approval of the President of the Reichsbank.

d. The foreign members of the first General Board shall be appointed by the Organization Committee. They shall be chosen with due regard to their professional qualifications and financial experience. In making the appointments, the Organization Committee may consult the principal foreign banks of issue and/or any other authorities in financial matters whose advice it may desire.

e. In case of vacancy in a position of a foreign member of the General Board, arising from death, resignation or other cause, there shall be a new election of another person of the same nationality to fill the vacant place. This election shall be by the foreign members of the Board who are in active membership at the time this election is held. Unanimity less one vote shall be necessary for an election. The new member shall always be chosen from among the nationals of the country of the member whose vacancy he is to fill. Before electing any foreign members of the Board, the Board shall consult, with reference to said election, the Central Bank of Issue of the country whose national is to be chosen and/or any other financial authorities of that country whom it may desire to consult.

f. The foreign members shall be chosen, one from each of the following nationalities: British, French, Italian, Belgian, American, Dutch, and Swiss.

g. On the unanimous vote of the General Board the number of German members may be increased.

h. No government official, or other person receiving compensation from the German government, or from any foreign government, shall become a member of the General Board.

i. Except as otherwise provided for by the Bank's statutes, decisions of the Board shall be by a majority vote of the ten (10) members, or by a simple majority vote if the President and the Commissioner are included in the majority. Should a member not be able to attend a meeting of the Board, it will always be open to him to empower one of his colleagues, by registered letter or by telegram, to vote for him and on his behalf.

j. At each of its meetings, and at least once every month, the

General Board shall examine the reports submitted to it by the President and the Commissioner. It shall adopt decisions on all the proposals made to it by the President and the Commissioner, provided that these decisions do not encroach upon the rights reserved to the President and the Managing Board as specified in Sections V and VI above.

k. The metal reserve of the Bank and the office for the printing of the notes shall be in Germany, but the General Board may, by a three-quarters' ($\frac{3}{4}$) majority vote, decide that either or both be transferred abroad to a neutral country.

VIII. THE COMMISSIONER

a. The Commissioner, who shall be a foreigner, shall be elected by a majority vote of not less than nine (9) members of the General Board, of which majority at least six (6) votes shall be those of foreign members. The Commissioner's term of office shall be fixed by the Organization Committee.

b. The Commissioner may be elected from among the members of the Board of foreign nationality, or may be chosen from outside the Board, from citizens of any one of the foreign countries represented on the Board. The election by the Board of a non-member to the position of Commissioner shall operate to vacate automatically, the position of the citizen of the country of which the Commissioner is a citizen. A Commissioner elected from outside the Board shall, by the fact of his election, become a member of the Board.

c. If, at the first election, the person chosen as Commissioner should be a member whose term, as decided by lot, in accordance with paragraph (b) of Section VII of this scheme, should only be one year, the term of this member shall automatically be increased to two (2) years. In this case, one of the two foreign members who have been assigned to two (2) years' term, shall have his term reduced to one (1) year. The decision as to which of the two foreign members shall have his term thus reduced from two (2) years to one (1) shall be made by lot.

d. It shall be an essential duty of the Commissioner to enforce the provisions of the law and the statutory regulations relative to the issue of notes and the maintenance of the Bank's reserves which guarantee that issue. To this effect, the Commissioner shall have the right to have furnished to him all statistics and documents

which he may deem useful for the accomplishment of his task, and whenever it appears to him necessary, he may make any investigations either in person or through his assistants. He shall be entitled to be present at the meetings of the Managing Board in Berlin.

e. The office entrusted with the custody of the reserve of notes shall only deliver notes when authorized by the Commissioner so to do.

f. The Commissioner shall be bound to the greatest secrecy in regard to all information he may obtain on the commercial operations of the Bank.

IX. LOANS, DISCOUNTS AND INVESTMENTS

a. The Bank shall make no loans or discounts having a maturity at the time the advance is made, in excess of three (3) months.

b. The Bank shall discount no notes or bills bearing less than three (3) names of known solvency, except that for one name there may be substituted collateral in the form of warrants relating to bona-fide commercial transactions or to goods. Such definition shall not be taken as including any notes issued or bills drawn in financial transactions or secured by stocks, bonds, or other investment securities but may include Treasury Bills of the German government.

c. The Bank may, with the special authorization of the General Board voting in the conditions laid down in paragraph *i* of Section VII, accept the long-term bonds of the Reich as collateral for loans with maturities not exceeding three (3) months if the loans bear two (2) responsible names, in addition to the collateral, one of these names being the name of a commercial bank doing business in Germany. Provided: that loans collaterally secured by the long-term securities of the Reich shall never exceed the amount of the Bank's net paid-in capital and surplus, except by the unanimous vote of all the members of the General Board save one.

d. The Bank shall make no loans nor advances on the security of real estate, mining property, oil property or stock shares; nor on the security of government obligations, except as otherwise provided for in this plan. The Bank may, however, take mortgages or titles to such property, stock shares and government debt bonds as additional security for loans previously made in good faith in accordance with provisions herein made.

e. Subject to the provisions contained in Article *a*, the Bank

shall make no loans, discounts, or other advances directly or indirectly, to the German Reich, any German State, Communes or other German governmental units, or to any foreign government or governmental units, nor shall it invest its funds in the bonds, debentures or other debt of any such governmental unit, except as otherwise specifically authorized by its constitutive law. The deposit accounts and current accounts in the Bank, of the German Reich, the German States, the German Communes or other German governmental units, shall never show a debit balance.

f. The Bank shall not accept time bills of exchange drawn against it.

g. The Bank may not buy or sell merchandise, produce, real estate or stock shares of other corporations for its own account.

h. The restrictions contained in the preceding paragraph shall not operate to prevent the Bank from buying such real estate, equipment and supplies as it needs for its own banking business, or from selling such property as may come into its possession in connection with the guarantee of statutory loans. Moreover, the Bank shall not be prevented, by the above restrictions, from buying in property where it needs to do so, in order to protect itself in the collection of statutory loans previously made in good faith and not paid at maturity.

X. SERVICE OF THE REICH'S TREASURY

a. The Managing Board is authorized to make advances from time to time to the Reich, but the amount outstanding at any one time shall never exceed 100 million marks. Such advances shall, in no case, be for a longer period than three months and in no case shall the Reich be indebted to the Bank at the end of the Bank's financial year, which shall coincide with that of the Reich. In consideration of these facilities, the Reich and its Treasury shall conduct all their domestic and foreign banking business through the medium of the Bank.

b. The Managing Board shall also be empowered to grant advances to the post office and the railways for reasonable amounts on condition that these organizations shall entrust the Bank, except in so far as the Bank might modify this condition, with the whole of their Treasury Service; but the total amount of loans outstanding to the post office and the railways together shall never exceed 200 million gold marks.

XI. SERVICE OF THE REPARATION TREASURY

The Bank will receive on deposit, sums paid for reparations, it being understood that the relationship between it and the Committee entrusted with reparation receipts shall be solely those of banker and customer.

This Treasury Service will proceed in conformity with the provisions of Annex 6 to the General Report. The maximum amount to be held on deposit for reparation account shall at no time exceed two (2) milliards of marks in conformity with Section X (a) of this Annex, except as otherwise provided therein.

XII. BANK NOTES

a. The Bank shall have the exclusive right of issuing and circulating bank notes in Germany during the period of its charter.

b. The German government may not itself issue any kind of paper money for circulation in Germany, during the period of the Bank's charter, nor shall it permit any German State, Commune, City, other governmental unit, corporation or private individual, to issue or circulate paper money in Germany during the period of the Bank's charter, with the exception of the banks of Baden, Bavaria, Saxony and Wurtemberg, which shall retain their charter of issue for sums not to exceed their present legal quota. The notes of the Rentenbank shall be gradually withdrawn from circulation under the conditions prescribed in Section XV and the Appendix hereto.

c. During the period of the Bank's charter, the Reich shall not issue any coins for circulation in Germany (except gold coins, containing approximately their full value in gold metal) of a larger denomination than five (5) marks; and shall not issue coins of five (5) marks or less, in excess of twenty (20) marks per capita of her population. All coins, other than gold coins, issued by the government, shall be issued through the Bank. They shall be received by the government in unlimited quantity at their nominal value, in payment of all taxes and other government dues.

d. The bank may issue notes for circulation, against gold coin or bullion, statutory discounts as defined in Section IX, demand credits in foreign banks and foreign commercial trade bills, with maturities of three (3) months or less, taken at their present gold values at current rate of exchange.

e. The notes of the Bank, as well as metallic currency, shall be

receivable in unlimited quantities for all taxes and other government dues in Germany. The notes shall be unlimited legal tender, unless otherwise specifically provided by contract, for all debts, public and private.

f. The notes of the Bank shall be accepted at their nominal value for all payments made to the Bank, both at the head office of the Bank in Berlin, and at all branches of the Bank located in Germany.

g. Notes shall be payable to bearer at the head office of the Bank in Berlin on presentation. The notes shall also be payable on presentation at the other offices and branches of the Bank, to the extent permitted by their cash reserves and monetary requirements. Payments may be made in any of the following forms, at the option of the Bank:

1. German gold coins of the present legal standard of weight and fineness, at par;

2. Gold bars, in denominations of not less than one (1) thousand gold marks, and not more than thirty-five (35) thousand gold marks, at their pure gold equivalent in German gold coin of the present legal standard of weight and fineness;

3. Demand drafts, payable in gold or in foreign currencies, at current market gold values, and drawn on funds located abroad in solvent banks to be specified by the Bank's statutes provided that the premia above the gold pars (or gold values, in the case of currencies not on a gold basis) charged by the Bank for such drafts shall never exceed the amount necessary to cover shipping expenses, including interest for the time of transit, on gold bars shipped in substantial quantities from Berlin to the foreign financial centre on which the draft is drawn.

The Committee is of opinion, however, that at the inception of the Bank, conditions will be unfavorable for the application of the above rule of convertibility; in this event, this rule may therefore be temporarily modified by the affirmative vote of every member but one of each of the following groups:

1. The Organization Committee.
2. The Managing Board.
3. The General Board.

In case of such modification, the Bank shall make all possible efforts and use all the means at its disposal in order to maintain the rate of exchange of the mark at as near gold parity as possible. Furthermore, in case of modification of the above-mentioned rule of convertibility of notes, a return to convertibility will be perma-

nently established as soon as possible, by a simple majority vote of the General Board and of the Managing Board.

h. While the Bank shall not make reimbursement for notes that have been lost or completely destroyed, it shall replace worn or torn notes, on application, by notes in good condition, at their nominal value; provided that such replacement shall not be required in the case of any note unless the part of the note presented shall constitute more than one-half of the note.

i. The notes of the Bank shall bear the facsimile signature of the President and the seal of the Commissioner.

XIII. RESERVES

a. The Bank shall always carry a normal reserve of at least thirty-three and one-third ($33\frac{1}{3}$) per cent of the total amount of its notes outstanding, subject to the following qualification:

In exceptional circumstances the reserve against notes may be reduced below thirty-three and one-third ($33\frac{1}{3}$) per cent on the proposal of the Managing Board, by a decision of the General Board; but said decision of the General Board shall require the affirmative vote of every member of the Board save one. In case of such a reduction in the reserve the Bank shall incur the following penalties, the proceeds of which it shall pay to the Reich: whenever the reserve against notes shall be less than thirty-three and one-third ($33\frac{1}{3}$) per cent of the notes outstanding and shall so continue for more than one week the Bank shall pay the following deficiency tax upon the amount by which the said reserve is less than thirty-three and one-third ($33\frac{1}{3}$) per cent of the notes outstanding:

When the reserve is below thirty-three and one-third ($33\frac{1}{3}$) per cent and not below thirty (30) per cent a tax of three (3) per cent per annum;

When the reserve is below thirty (30) per cent and not below twenty-seven (27) per cent, a tax of five (5) per cent per annum;

When the reserve is below twenty-seven (27) per cent and not below twenty-five (25) per cent, a tax of eight (8) per cent per annum;

When the reserve is below twenty-five (25) per cent a tax of eight (8) per cent per annum plus one (1) per cent per annum for each one (1) per cent the per cent tax figure is below twenty-five (25) per cent.

b. No discount rate or rediscount rate shall be below five (5) per cent per annum when the reserve mentioned in the preceding paragraph shall have continuously, for one week or more, been below thirty-three and one-third ($33\frac{1}{3}$) per cent of the bank-note liabilities there mentioned.

c. Whenever a deficiency tax is payable, a percentage equal to at least one-third ($\frac{1}{3}$) of the percentage rate of the tax payable shall be added to the Bank's discount rate and rediscount rate, in addition to any increase in the said rates required to comply with the provisions of the preceding paragraph.

d. The above-mentioned legal reserve may be kept in gold bars or gold coin, at any office of the Bank, and or in the form of demand deposits, made payable in gold or its equivalent, at the rates at which the deposits were made, in banks of high standing located in foreign financial centres.

e. The Bank shall also hold a special reserve of gold and gold deposits, of the same character required to be held against its notes in circulation, to the amount of twelve (12) per cent of its deposit liabilities. Whenever the above reserve is continuously, for one week or more, below said twelve (12) per cent, the Bank shall pay a deficiency tax of four (4) per cent per annum on the amount by which the reserve is less than twelve (12) per cent and not less than ten (10) per cent; a tax of eight (8) per cent per annum on the amount by which it is less than ten (10) per cent and not less than eight (8) per cent; and a tax of ten (10) per cent per annum in addition to said eight (8) per cent for each one (1) per cent by which the percentage figure is below eight (8) per cent.

f. In order to assure adequate liquidity in the assets securing the Bank's deposit liabilities the Bank shall at all times hold in addition to its afore-mentioned gold reserve of twelve (12) per cent demand deposits in Germany and abroad, cheques on other banks, and statutory notes and bills of a commercial character, payable at call or on time with maturities of less than thirty (30) days to the amount of not less than thirty (30) per cent of the Bank's total deposit liabilities.

g. The above-mentioned reserves and the liquid assets above described shall be segregated for the service of the Bank's deposits.

XIV. PROFITS

The net profits of the Bank, at the end of each financial period, shall be employed as follows:

a. Twenty (20) per cent shall be transferred to surplus or reserve until the Bank's actual net paid-up capital and surplus shall amount to twelve (12) per cent of its average liabilities on circulating notes, on the fifteenth day of the six preceding months. If the ratio shall again fall below this twelve (12) per cent, the above-mentioned allotment of twenty (20) per cent of the net profits to surplus or reserve shall continue. When and so long as the ratio of the Bank's net capital and surplus or reserve to its average liabilities on circulating notes, as above computed, shall exceed twelve (12) per cent, the Bank may use its discretion as to the percentage of its net profits it will transfer to surplus or reserve provided that the percentage thus transferred shall never exceed twenty (20) per cent.

b. A sum shall be assigned to the payment of dividends sufficient to pay eight (8) per cent per annum on the Bank's shares.

c. The balance of the net profits shall be divided as follows:

1. One-half ($\frac{1}{2}$) to the shareholders, in dividends or to a special fund to be used for the maintenance of a uniform dividend policy.

2. One-half ($\frac{1}{2}$) to the government, as a franchise tax for the Bank's exclusive privilege of issuing circulating bank-notes.

d. The dividends of the Bank and other income derived from its capital shares owned by foreigners residing abroad shall be exempt from all German income taxes, present and future; provided that this exemption shall not apply to general taxes imposed in Germany upon the real property of the Banks in general. The Bank, however, in consideration of the percentage of profits accruing to the government under paragraph c 2, shall not be subject to any corporation tax or business tax levied in Germany by the Reich, the States or any other governmental unit.

e. Such privileges not inconsistent with this plan, now enjoyed by the Reichsbank, as may be specified by the Organization Committee as desirable and advantageous to the new Bank shall be given to it.

XV. LIQUIDATION OF THE RENTENBANK

The rentenmarks shall gradually be withdrawn from circulation by the Bank in accordance with the provisions contained in the Appendix attached.

XVI. DOLLAR-SCHATZANWEISUNGEN**(Treasury Bills in Dollars)**

a. The German government shall abandon all its rights to the proceeds from the liquidation of the Reichsbank (unless the present plan is put into execution by means of the transformation of the Reichsbank), in return for which the latter will give the government an undertaking to assume responsibility for the repayment of the said bills not in excess of 210 million gold marks, under conditions to be settled by the Reichsbank with the holders of these bills.

b. At the same time, in order to guarantee the good faith of this operation, that is to say, in order to guarantee the Reichsbank against any loss resulting from this operation, the German government shall hand over to the Reichsbank gold bills for an amount equal to and falling due at the same date as the dollar bills in circulation. As soon as the liquidation of these dollar bills has been completed, the Reichsbank will return to the German government the portion (if any) of the bills which it has received, and which has not been employed in ensuring the liquidation.

XVII. THE REICHSBANK

a. If the present plan is put into execution by means of the transformation of the Reichsbank, the latter shall redeem the outstanding circulating notes in its new notes, at the rate of one trillion (1,000,000,000,000) marks to one (1) gold mark. The old notes shall be immediately withdrawn from circulation and cancelled.

b. The Reichsbank, in case it is continued, shall meet the same reserve requirements against the outstanding notes which it undertakes to exchange, in accordance with the provisions of paragraph *a* of this section, as are required to be held against bank-notes outstanding by Section XIII of this plan.

c. If the Reichsbank is to be liquidated, this operation will be carried out by the new Bank which would be then set up, and which would have to assume responsibility for, or itself carry out, the exchanges provided for in paragraphs *a* and *b* above.

XVIII. PENALTIES

A penalty in the form of fine or imprisonment or both shall be provided for the punishment of any person or persons wilfully giving

incorrect information, directly or indirectly, to the President, the General Board, the Commissioner or his assistants.

XIX. MEASURES TO BE TAKEN BY THE GERMAN GOVERNMENT FOR THE EXECUTION OF THE PLAN

All the undertakings which the German government will have to enter into in connection with the Bank, for the execution of this plan, including the assignment for the withdrawal of the Rentenmark, of funds to be received from the Rentenbank's mortgages, shall be embodied in a special contract between the Bank and the German government. This contract as well as the statutes of the Bank shall be duly approved by the German Parliament.

APPENDIX TO ANNEX 1

THE LIQUIDATION OF THE RENTENBANK

(Appendix Provided for in Section XV of the Plan for the Bank)

The Deutsche Rentenbank was founded, and its operation regulated, by the Decree of October 15, 1923.

The capital and the initial reserve were fixed by this Decree at 3,200 million Rentenmarks, to be furnished half by agriculture and half by industry and commerce, including the banks.

The Rentenbank holds a general mortgage, expressed in gold marks, on industrial, agricultural and commercial property, amounting to 4 per cent of the value of this property as assessed for the Wehrbeitragsgesetz.¹

These mortgages bear 6 per cent interest for the benefit of the Rentenbank.

The Rentenbank is authorized to issue bank-notes expressed in Rentenmarks up to the amount of the capital and initial reserve (3,200 million gold marks).

The Rentenbank must open credits to the Reich during the two years following its foundation, up to the amount of 1,200 million Rentenmarks, of which 900 millions will bear 6 per cent interest and 300 millions will bear no interest. The Rentenbank is authorized, moreover, to open credits to the Reichsbank and to the private Banks up to 1,200 million Rentenmarks, in order to finance private economy.

Up to the present the Rentenbank has placed in circulation:

1. Seven hundred millions which have been delivered to the Reichsbank in order to provide for the credits to be granted by the latter to German manufacturers and merchants. This sum is there-

¹ The amount of this mortgage already amounts to 3,700 million gold marks.

fore guaranteed by drafts or credits redeemable in Rentenmarks. If and when the Rentenbank is liquidated, no attention need be paid to them.

2. Eleven hundred million Rentenmarks which have been advanced to the Reich without any security but the signature of the latter, 900 millions of which bear 6 per cent interest per annum and 200 millions bear no interest.

In so far as concerns this latter sum of 1,100 millions the new Bank (or the Reichsbank, if it is maintained) would assume the obligation vis-à-vis the holders of these notes to redeem them gradually within ten years. To this effect the Rentenbank would undertake to remit to the Bank, as fast as they came in, all sums received from its debtors whether from the property holders affected by the Rentenbank mortgage or from the State, up to the sum of 1,100 millions.

This undertaking of the Rentenbank vis-à-vis the Bank would be covered by all the mortgages and guarantees which it holds, as well as by the guarantee of the German government itself.

It should, moreover, be understood that all profits accruing to the Reich in virtue of its participation in the Bank would be assigned by priority to the amortization of its debt of 1,100 millions.

As soon as the payments by the Rentenbank or by the Reich itself, as stated above, reach the figure of 1,100 millions the German government and the Rentenbank will be released from all liability vis-à-vis the Bank.

ANNEX No. 2

TO THE REPORT OF THE FIRST COMMITTEE
OF EXPERTS

SUGGESTED INDEX OF PROSPERITY

BASIS OF COMPARISON

1. In addition to the standard contribution referred to in paragraph VIII c, there shall be paid for 1929-30 and following years a supplementary sum according to the growth in prosperity of Germany. This increase in prosperity for any year shall be measured by the extent to which the index, as defined below, on the statistics of the completed preceding year, exceeds the average statistics of the base years.

COMPONENTS OF THE INDEX

2. For the purpose of computing the index the following statistics shall be employed:

- a.* The total of German exports and imports taken together;
- b.* The total of budget receipts and expenditure taken together, including those of the States of Prussia, Saxony and Bavaria (after deducting from both sides the amount of the Peace Treaty payments included in the year);
- c.* Railroad traffic as measured by the statistics of the weight carried;
- d.* The total money value of the consumption of sugar, tobacco, beer and alcohol, within Germany (measured by the prices actually paid by the consumer);
- e.* Total population of Germany (computed from the last available census data, vital statistics and emigration records);

f. The consumption of coal (and lignite reduced to coal equivalent) per capita.

THE INDEX BASE

3. In computing the *base* the average statistics for the *three* years 1927, 1928 and 1929 shall be taken for *b* budget receipts and expenditure, for *e* population and for *f* coal consumption per capita, and for the *six* years 1912 and 1913, 1926, 1927, 1928 and 1929 for the other categories (after appropriate adjustments for the differences in population and the altered gold values to make the three earlier years comparable with the three later years in this respect). The percentage change for each of these six groups, compared with the base, shall be separately computed and an arithmetical average of the six percentage results taken as the index.

PAYMENT TO WHICH THE INDEX IS APPLIED

4. The index percentage shall be applied to the amount of the standard payment, viz., 2,500 millions, to give the supplement for the year, except that for the five years 1929-1930 to 1933-1934 it shall apply to 1,250 millions, or one-half of the standard payment only.

MINUTE ADJUSTMENTS IGNORED

5. The supplementary payment is to be reckoned only for each half per cent of the index, i.e., an index average of 11.35 per cent would be reckoned as 11 per cent.

COMPUTATION OF SUPPLEMENT

6. For the year 1929-30 the computation of the supplement shall be made after the end of that year by comparing the statistics of 1929 itself with the index base.

DEFICIENCIES

7. In the event of the index in any year producing, as the supplement, a minus quantity, the basis payment should continue to be made, but subsequent supplementary payments shall not accrue due until allowance has been made therefrom for such deficiency or "minus" payment of previous years.

DIFFICULTIES IN APPLICATION

8. Any disputed points upon the application of the statistics of this index shall be referred to the Finance Section of the League of Nations for arbitration.

CHANGES IN THE VALUE OF GOLD

9. The German government and the Reparation Commission should each have the right in any future year, in case of a claim that the general purchasing power of gold as compared with 1928 has altered by not less than 10 per cent, to ask for a revision on the sole and single ground of such altered gold value. The alteration to be made may apply both to the standard contribution and the supplementary payment. Failing mutual agreement, a decision should be given by an arbitral committee appointed by the League of Nations. After decision, the altered basis should stand for each succeeding year until a claim be made by either party that there has again been a change, since the year to which the alteration applied, of not less than 10 per cent.

The alterations under this paragraph should be made by reference to such generally approved index numbers of prices (German or non-German), singly or in combination as the arbitration may decide.

ANNEX No. 3

TO THE REPORT OF THE FIRST COMMITTEE OF EXPERTS

GENERAL REPORT ON THE GERMAN RAILWAYS MADE TO THE FIRST EXPERT COMMITTEE BY SIR WILLIAM ACWORTH AND MONSIEUR LEVERVE

NOTE BY THE FIRST COMMITTEE OF EXPERTS

Of the assets and revenues of the German Reich and its constituent States subject to the application of Article 248 of the Peace Treaty, the German railway system is undeniably the most important and also that which can be the most easily utilized for the purpose of reparation.

The German railway system comprises about 53,000 kilometres of lines, and the rolling-stock will very shortly amount to:

Locomotive engines (excluding electric and motor engines).....	30,850
Passenger vehicles.....	69,253
Wagons.....	748,753

A considerable portion of this rolling-stock is of recent construction. Two-thirds of the whole (18,000 locomotives and 500,000 passenger vehicles and wagons) were brought into service in the last ten years. The rolling-stock at present possessed by the German railway system is very superior both in quality and quantity to that which was in use before the war.

Speaking generally, it may be said that the equipment of the German railways is modern and fully up to the level of the latest improvements in railway technique.

The capital cost of the system amounts to not less than 26 milliard gold marks.

The Experts called in the services of eminent railway specialists, and requested them to make a study of the German railways; their report is attached.

GENERAL REPORT ON THE GERMAN RAILWAYS

MADE

TO THE FIRST EXPERT COMMITTEE

BY SIR WILLIAM ACWORTH AND M. LEYERVE

March 26, 1924.

In our earlier reports we described the situation of the German railways and replied to various questions asked by the Committee, especially as to the amount of net revenue which we considered they could yield for reparation purposes. We have now, as requested by the Committee, brought together in a single document the essential portions of these reports together with our own conclusions.

We desire to thank the German Minister of Railways and his staff for the manner in which they have assisted our inquiry in Berlin with information both verbal and documentary. In the short time at our disposal it has naturally not been possible for us to push our investigations very far, but we trust that the report which we now present is adequate for the purposes of the Committee, and we think its substantial accuracy may be relied on.

CAPITAL INVESTED IN THE GERMAN RAILWAYS

In a preliminary report we stated that the capital value of the German railways might safely be taken at not less than 20 milliard gold marks. An official publication shows that the debt of the several States specifically entered as railway debt, less that portion of it applicable to the ceded territories, amounted in 1914 to 17.93

milliard gold marks. In March, 1920, at which date the railways were transferred from the ownership of the several States to that of the German Reich, the invested capital was reckoned as 25-28 milliard gold marks. This large increase is explained by the fact that at the date of the transfer:

a. The value of the railways of the separate States was written up to conform to the real amount of capital that had been invested in them, much of which had never been or had ceased to be represented by railway debt;

b. There was added to the old capital the value of the additions made during the war.

Between March, 1920, and March, 1923, the capital invested was further increased to 25.86 milliard gold marks. The expenditure for the current year and that which will still need to be incurred in payment for commitments already entered into will put the final figure well over 26 milliard gold marks.

The above figures represent capital invested, which is sometimes a very different thing from capital value. But in this case the capital value of the German railway system which comprises 53,000 kilometres at 500,000 gold marks per kilometre may be taken to be fully equal to the capital invested. Now a large part of the system is double tracked; the lines, stations, yards and buildings have been constructed to a high standard, and they are very amply equipped with up-to-date rolling stock. A comparison with the capital cost per kilometre of the railways of other important countries, taking account of all the factors on both sides, gives good grounds for saying that the German figure of investment is by no means an excessive representation of actual cost.

NET REVENUE ATTAINABLE

We think that a net annual revenue of one milliard gold marks per annum can reasonably be expected from the German railways. This is very slightly more than the net revenue earned before the war; but it was then earned very easily. No attempt was made to maximize net revenue, which was much more than sufficient to meet the interest on the railway debt.

On the one hand, the tariffs were kept low, especially for passengers. The guiding principle was, as has been recently expressed in a brochure published by Dr. Sarter, whose statement, as he is a highly placed official in the Transport Ministry, may be taken as

authoritative: "The State railways ought primarily to have regard to the progressive development of the economic life of the country and to treat the attainment of net revenue as only of secondary importance."

On the other hand, the operating expenses were unduly high; the staff was unnecessarily large; and magnificent stations and enormous shunting yards were worked at a great expense. Moreover, as is shown by the figures which we have given above, the working expenses included year by year large sums for improvements and additions which might properly have been charged to capital.

It may be thought—seeing that for some years past the gross receipts of the German railways have not covered their expenses, and that recently the expenditure was several times as great as the receipts, while even now the earnings are only equal to the expenditure—that this estimate of ours is unduly sanguine.

But it is to be remembered that since the war almost every country has gone through a similar experience. Even in the United States, where there was no currency depreciation, the net income of the railways in 1920 was almost negligible; whereas in England, where currency depreciation is quite small, the receipts in 1921 fell short of the expenses. But in both countries the situation has now completely changed, and if in other countries the railways have still not regained financial equilibrium, experience sufficiently shows that this phase is only temporary. And Germany has one special circumstance of the first importance in her favor. On the railways of England and America the wages of the railway staff are roughly double what they were before the war. No such advance has taken place in Germany. On the contrary, the average wage is at present, we are informed, only 75 per cent of the pre-war wage. It is proposed in the current year to increase this percentage to 93 per cent of the pre-war average. But there is no prospect of any such increase above the pre-war standard as has taken place in the two countries mentioned. And this for two reasons: the cost of living has not increased in Germany as it has there, and, as German wages in other occupations have not risen, railway wages do not compare unfavorably.

Naturally we do not suggest that a milliard of net revenue is attainable at the outset. But we think a substantial sum can be obtained very shortly, and that the full amount should be reached within a period of three years. It should be arrived at in the manner following:

During the war there was imposed in Germany, as in other countries, a transport tax. This tax still continues to be levied. It is included in the rates charged to the public but is paid over by the railways direct to the Finance Ministry and forms therefore no portion of the railway revenue. It is a tax on the gross receipts, and is fixed at 7 per cent on all receipts from freight traffic other than coal, and at 10 per cent to 16 per cent, according to class, on passenger traffic. On the average it amounts to 6 per cent of the total gross receipts. It is estimated to produce in the year 1924 227 million gold marks. If in future years the traffic increases, or if the same volume of traffic is charged at a higher rate, naturally the proceeds of the tax will increase proportionately. It seems safe to assume that its yield will not fall below the present figure. Moreover, as it is levied on the gross and not on the net income, it is independent of any variations in the cost of operation. If, as we recommend, the German railways in future are required to pay over the proceeds of this tax to the Reparation Commission, the Commission will have from the outset a safe and important source of revenue at their disposal.

There remains a sum of 800 million gold marks in round figures to be obtained, and it can, in our judgment, be obtained as net profit on the railways, on condition that the tariffs are fixed at a reasonable level, that the number of employees is reduced to a reasonable figure, and that in all other matters curtailment of expenses is secured by economical operation on business lines.

Before the war the German railways spent 70 marks for every 100 marks which they earned. In technical railway language the "operating ratio" was 70 per cent. This was an unusually high ratio, especially having regard to the fact that the railways paid no taxes. It was a good deal higher than the English ratio, much higher than the ratio in France. But in every country there has been since the war a marked increase in the ratio, and we do not think that under post-war conditions the German railways can be expected to operate at a ratio so low as 70 per cent. Not only have they now to bear the transport tax, but, though a great rise in wages—the main cause of the rise of the operating ratio in other countries—is not to be expected in Germany, the increased cost of materials, coal and steel particularly, seems likely to be permanent. We think, however, that an operating ratio of 80 per cent ought to be attainable. We base this opinion in the first place on our investigation of German conditions, and especially on two facts:

(1) That new rolling-stock has been acquired in the last few years in such large measure that the need of repairs and renewals will be exceptionally small for some years to come, and

(2) That the recent very large expenditure on fitting the freight wagons with continuous brakes should result in important operating economies.

In the second place, we think our knowledge of what has happened and is happening in other comparable countries justifies us in asserting in broad terms that, given efficient and economical management, there is no apparent reason why the operating ratio should not be brought back in a short time to 80 per cent in Germany as it has already been brought back elsewhere.

In England and America, as we have said, the wages of the staff have doubled, but the tariffs are only roughly 50 per cent above the pre-war tariffs. In the result, the operating ratio has become much higher than before and stands at present at about 80 per cent. But the remaining 20 per cent, calculated on a greatly increased gross revenue, suffices to give a return of over 4 per cent on the railway capital.

Now in Germany a gross revenue of 4,000 million gold marks per annum is in sight at the present moment. With a gross revenue of 4,000 million gold marks per annum and an operating ratio of 80 per cent, the net revenue would be 800 million gold marks. And this sum added to the 227 million gold marks of the transport tax yields a total of over 1 milliard gold marks.

And the whole of this sum can be made available for reparation. The fall of the mark has wiped out the pre-war railway debt; the plan before the Committee will, we understand, relieve the railways under the new management of responsibility for the debts recently incurred; and capital has been so lavishly spent in the last few years that there can be no justification for further expenditure for some years to come. In future years we assume that, under commercial management, new capital will not be spent, unless with the assurance that the resulting profits or economies will at least suffice to meet the interest.

We shall revert to the matter of receipts and expenditure when we come to discuss the budget estimate for the year commencing April, 1924.

Meanwhile it may be useful to approach the subject from another point of view.

One milliard is less than 4 per cent on the railway capital of 26

milliards. If we deduct the transport tax, which certainly does not exceed in amount the taxation levied on railways in other countries, the German railways are only required to earn a fraction over 3 per cent on their capital. And as already stated, we have no reason to think that the German railways are over-capitalized; 3 per cent can hardly be regarded as an excessive rate of interest.

In England the Rates Tribunal is required by statute to permit the railways, provided that their management is efficient and economical, to charge rates adequate to produce a net income of roundly 1 milliard gold marks on a capital somewhat less than that of the German railways. In America, the Interstate Commerce Commission, also acting under statutory authority, has decided that 5 $\frac{3}{4}$ per cent is a reasonable return on railway capital, and has authorized rates regarded as sufficient to produce this return.

If the German railways are required to pay very little more than 3 per cent for reparations, they ought, under efficient and economical commercial management, to earn a substantial surplus over and above, which can be applied in relief of the general taxation of the country. At the same time, it should be understood that the profits on railways, like those of other commercial undertakings, vary from year to year. They are good times and bad times. The milliard which we have assumed as a reasonable return must be regarded as an average one year with another.

As we have already said the full net revenue will not be attained from the outset. A period of some years will probably need to elapse. For the German traffic has been seriously affected by the occupation of the Rhine-Ruhr railways.

Time will be needed after the railways have been reorganized as a united system to bring the new system into work and to re-establish completely the old traffic. And this reorganization will mean expenditure. Further, the necessary reform of the management will take time to carry out and will not produce its full effect at once.

For all these reasons and naturally without committing ourselves to mathematical accuracy we think it reasonable to estimate that the net revenue apart from the transport tax, and after providing for building up of an adequate reserve, will increase as follows:

	Million gold marks
1st year.....	400
2nd year.....	550
3rd and 4th years.....	700 to 750
5th and subsequent years.....	800

Measures to Obtain Results

It is evident in the first place that the railways in common with every other German undertaking can only give satisfactory results if the currency is stabilized and political and social tranquillity prevails.

As for the measures to be taken to obtain the results indicated above, we may repeat: the railways must be worked as a commercial enterprise, that is to say, with the determination on the one hand so to fix the rates as to produce all the receipts that can be obtained, and on the other hand to reduce the expenditure to a minimum. The management of the German railways has hitherto been far from working to this standard. We shall show later that since the war the tariffs both for passenger and freight have been kept too low, with the object of encouraging industry and commerce, and especially of favoring German export. The tariffs are still regarded as they were before the war, primarily as a weapon in the hands of German trade, and only secondarily as a source of railway revenue.

On the other hand, the expenditure on rolling stock and works of every kind has been extravagant since the war, and the staff employed is at the same time much too large and badly paid.

It is therefore indispensable to make a radical change in the policy followed by the railways hitherto. But we do not believe that any German management will have the strength necessary to fight successfully against the traditional mental attitude, unless there is behind it the constant pressure of an expert control, established and maintained in the interests of the Allies, to supervise the management in the matter both of tariffs and of expenditure.

We shall deal later with the question of the Control in greater detail.

Further, we regard a complete change in the organization as essential. We think that the recent establishment of a separate undertaking, with a separate budget and with a certain measure of independence, though it is a move in the right direction, does not go far enough. The undertaking, though separate, still remains a government undertaking. In our judgment it is necessary to go further and, while leaving to Germany the ownership of the railways, to entrust the management for a period of years to a commercial company, which will be German, but with a board of directors con-

taining representatives both of the share holders and of the creditor Allied Powers.

What this period of years shall be, how the company should be constituted, with what powers, and with what restrictions, is a matter which we understand the Committee itself will deal with. We need only urge that the company and its management must have adequate freedom in the matter both of tariffs and operation. And if we may vary the phrase of Dr. Sarter, we think that a commercially managed railway company ought to treat the attainment of an adequate net revenue as of primary importance, while at the same time having regard to the progressive development of the economic life of the country, and being careful not to kill or even impair the productive capacity of the goose that lays the golden eggs.

Moreover, as we have already said, the financial result which we have mentioned can only be attained on condition that the entire German railways are either united in one system under a single management, or divided in a reasonable manner into several systems working in harmony, with the same tariffs and under the same general regulations. If we had to contemplate separate systems wholly out of harmony with each other, the results obtained would certainly not correspond to our estimate of the net revenue obtainable.

Though that estimate assumes the existence of an undivided German railway system, it will of course be understood that, in making this assumption we do not express any opinion as to the course of action which the Allied governments may think it desirable to adopt or on the general question of military or economic guarantees for reparation and security.

Finally, our estimate takes for granted that the railways will not be required to carry traffic for the government or the community, unless their services are paid for at a commercial rate. Hitherto the German railways have carried free for the Post Office not only mails but parcel traffic. The railways of Great Britain receive at the present time from the Post Office payments for similar though smaller services amounting to more than four million pounds sterling per annum. There are other instances of a similar kind but of less importance with which it is not necessary to deal here.

FUTURE CAPITAL EXPENDITURE

We shall see later that the expenditure incurred since the war for new works, and especially for rolling stock has been very large. It has in our judgment gone much beyond the real needs of the railways.

For rolling stock alone there has been charged against the various budgets, a sum of more than 3 milliard gold marks, which has enabled the railways to acquire more than 18,000 new locomotives and more than 400,000 new carriages and wagons.

We think therefore that, broadly speaking, the capital account can be entirely closed for some years to come, without any injury to the railways. But at the same time we must not fail to call attention to the statement of the German government that the capital expenditure to be incurred in the year 1924 will amount to over 500 million gold marks, and that to complete the program a further expenditure of 236 million gold marks will be required in 1925. We think that this program ought to be examined in detail, and very drastically cut down.

Still, after a certain time it will no doubt be necessary to incur new expenditure in enlarging stations or building new lines. But as we have already said, a commercial administration will not embark on new capital expenditure unless it is evident that it will be directly reproductive. The cost can therefore be paid either directly, out of increased net revenue, or if it is sufficiently important to justify this course, by loans charged on the increased revenue without trenching on the revenue pledged for reparations.

THE RAILWAY BUDGET—ORDINARY BUDGET

It seems desirable to examine the estimate for the ordinary budget for the financial year from April 1, 1924, to March 31, 1925—in German financial matters called the year 1924—which has been drawn up by the German administration.

It has been drawn upon the supposition that the Rhine-Westphalian Railways have been restored to German management. But even if and when this happens, it is probable that there will be confusion at the outset; a certain time must necessarily elapse before the normal working can be resumed and the ordinary currents of traffic restored; and further, certain exceptional expenses will have to be incurred which it is impossible to estimate exactly.

This budget is therefore somewhat theoretical, and may be considered as representing the results to be obtained in the year 1925 rather than in the year 1924. Subject to these reservations, we will proceed to summarize and examine it.

ORDINARY BUDGET INCLUDING THE RHINE-WESTPHALIAN RAILWAYS

I. EXPENSES

	Gold marks
<i>a.</i> Salaries and Wages.....	1,631,007,000
<i>b.</i> Cost of Material:	
Supplies and consumable stores	545,000,000
Maintenance of way and works	294,480,000
Maintenance and renewal of rolling stock and mechanical plant.....	394,000,000
Other material costs.....	140,513,000
Reserves.....	200,000,000
Interest and repayment of debt	325,000,000
	1,898,993,000
Total.....	3,530,000,000

II. RECEIPTS

	Gold marks
Passenger traffic.....	850,000,000
Freight traffic.....	2,700,000,000
Miscellaneous.....	130,000,000
Total.....	3,680,000,000
Surplus.....	150,000,000

Receipts

The receipts for the budget in 1924 have been calculated by assuming a traffic somewhat greater than that in 1913, but less than that in 1921 and 1922, in which years the traffic was swelled by the activity of trade due to the fall of the mark.

The figures are as follows:

	Actual in 1913	Estimate for 1924
Passenger kilometres..	35,122 millions	40,000 millions
Ton kilometres.....	57,251 millions	60,000 millions

The passenger receipts have been calculated on the basis of the tariffs which were in force at the time when the budget was framed. Later on, when we come to deal with tariffs, we shall point out that the 3rd and 4th class fares were too low, and that the 1st class fares which affect only a trifling number of passengers, were too high. Since March 1st the 3rd and 4th class fares have been increased by 36 per cent, and the 1st class fares have been slightly reduced. We may assume that the result will be an increase in passenger receipts of 30 per cent, which will raise the budget estimate of 850 million to roughly 1,110 million marks.

The freight receipts have been calculated on the basis of an average charge of 4.5 gold pfennigs per ton kilometre. The tariffs in force last February, at the time of our visit to Berlin, gave a higher average receipt per ton kilometre of 5.5 gold pfennigs. But a general reduction of 10 per cent was made on March 1st, and others are in contemplation with the special object of encouraging national trade and industry. As we shall explain later, these reductions do not seem to us justified under present conditions. If rates were maintained at a reasonable level, we may assume that the freight receipts would be about 10 per cent above the budget estimate of 2,700 million marks, that is, they would amount to 2,970 million marks.

The receipts side of the budget would then be as follows:

	Million gold marks
Passenger traffic.....	1,100
Freight traffic.....	2,970
Miscellaneous.....	130
Total.....	4,200

Expenses

As for the estimate of expenses for 1924, it is to be noted that the expenditure for staff, 1,631,007,000 gold marks, represents about 54 per cent of the actual working expenditure of 3,005 million gold marks. If we exclude interest and repayment of debt, and reserve, neither of which are properly included in working expenses, this proportion is much the same as that on the railways of the adjacent countries. We pointed out in previous Notes that the staff was unreasonably large. In 1919 there were 1,121,111 permanent staff and workmen employed; at the end of 1923 the number was still very nearly one million. They must have been extraordinarily badly paid, for the percentage of the wage bill to the total expenditure was reduced in the budgets of 1922 and 1923 to 29 per cent and 20 per cent, respectively, a figure absolutely abnormal.

The expenditure for 1924 has been calculated on the basis of a staff reduced to 793,000 although on the 1st of January the number was still 936,800. A very drastic reduction is therefore implied, and is in fact being carried through at this moment. But there will be no saving in money. Increase of wages will more than counter-balance the decrease in the number of staff, for an increase of salaries and wages amounting to 18 per cent on the average is budgeted for. A table of the variations in the average payment is given below:

AVERAGE PAYMENT PER EMPLOYEE PER ANNUM IN GOLD MARKS

	Year	Feb.,	Budget estimate for 1924
	1914	1924	
Permanent staff.....	2,352	1,634	1,972
Workmen.....	1,331	1,060	1,338
Average.....	1,718	1,293	1,595
Percentage of pre-war average...	100	75	93

We feel bound to say that the increase proposed is entirely reasonable. The remuneration of the staff, especially in the upper and middle ranks, is quite inadequate, and if good work is expected, it must be paid at its market rate.

A reserve of 200 million marks has been included to provide for contingencies, a course which we can not other than approve.

	Million gold marks
The total expenses for the year 1924, including this reserve and interest and repayment of debt, to which we shall refer later, are set down in the budget as	3,530
With the tariffs on the basis which we have taken above, the receipts will be.....	4,200
This would give a surplus of.....	670

This surplus would be net profit because the reserve of 200 million and 325 million gold marks for interest and repayment of the new debt has been included in the expenses.

Further, it is to be remembered that the transport tax represents in effect a further net profit from the railways. If we reckoned this tax at 10 per cent on the passenger receipts and at 7 per cent on the receipts from freight other than coal, we should obtain for 1924 a figure of 276 million gold marks.

The total net income of the railways would then be $670 + 276 = 946$ million marks, which is very close to the milliard which we have suggested is attainable within a few years.

But as we have said already, these results are applicable to the entire German railways worked as a single system, including the Rhine-Westphalian lines, under normal conditions. Certainly they will not be obtained in the year 1924, though they should be obtained very shortly thereafter.

INTEREST AND REPAYMENT OF DEBT

The sum of 325 millions set down in the budget for interest and repayment of debt during the year 1924 is divided into:

	Million gold marks
Interest.....	99
Repayment.....	225
Cost of Administration.....	1
	325

This debt represents liabilities recently incurred, for the old debt has practically disappeared. The total amount of the current debt is 312 million marks. Particulars are given in the reply of the government to questions asked by the Committee. There are short-term loans, overdue accounts, bills of exchange maturing, advances made by the Ministry of Finance or by the Reichsbank, and emergency currency issued by the railways which has to be redeemed. The interest charge for these debts is quite large. In certain cases we are told that interest is running at the rate of one-tenth of one per cent per diem, that is, 36 per cent per annum. Evidently debts of this kind should be paid off as soon as possible.

In addition to these current debts amounting to 312 millions, it is estimated that further debt will need be incurred as follows:

	Million gold marks
Commitments for extraordinary expenses up to March 31, 1924.....	110
For the expenditure of the extraordinary budget during the financial year 1924..	387
For expenditure which will be necessary when the Rhine-Westphalian Railways are handed back.....	200
	697
Add debt already incurred.....	312
Total debt, actual and anticipated..	<u>1,009</u>

As we have said, the ordinary budget for 1924 provides an amount of 225 million marks for repayment of debt. But it is evident that these expenditures charged on the extraordinary budget tend to increase rapidly, and it is therefore necessary to cut down the extraordinary budget. To this question we now turn.

THE EXTRAORDINARY BUDGET

A budget of extraordinary expenditure has been drawn up for the interim period from November 15, 1923, to March 31, 1924. It covered originally an expenditure of 220 million, but was subsequently reduced to 170 million marks divided as follows:

CHAPTER I

	Million gold marks
Dwellings.....	8
Additional rolling stock.....	77
Kunze Knorr brake.....	3
Miscellaneous.....	15

CHAPTER II

Doubling of road.....	6
Electrification.....	6
Stations.....	32
Repair shops.....	13
Miscellaneous.....	10
Total.....	170

These expenses are to be covered partly by credits already available, and partly by new credits to an amount of 110 millions.

The Ministry has also furnished us with a statement of other extraordinary expenses which in their judgment are still necessary for the financial year 1924. We summarize them as follows:

CHAPTER I

	Million gold marks
Dwellings.....	15
Additional rolling stock.....	110
Electric rolling stock.....	20
Kunze Knorr brake.....	28
Miscellaneous.....	40

CHAPTER II

New tracks.....	10
Doubling of road.....	13
Electrification.....	10
Stations.....	94
Repair shops.....	36
Miscellaneous.....	11
Total.....	387

In addition to this expenditure of 387 million marks in 1924, it is estimated that a further sum of 236 millions will subsequently be required merely to complete works already begun. This represents the final state of a program amounting altogether to 1,610 million marks.

This estimated expenditure, which will have to be covered by loans, has, so we are told, already been reduced to an absolute minimum. All the same, we think it ought to be re-examined point by point in order to stop or at least postpone work not absolutely necessary, except where it has been carried to such a point that it has better be completed.

The works and the rolling stock of the German railways were very fully adequate before the war. Since the war no money has been spared to enlarge works and buildings and to renew and even increase the rolling stock to an extent which will make it impossible to justify any new expenditure of this nature for some years to come. We give below particulars as to the rolling stock which bear out this statement.

ROLLING STOCK

Below is a comparison based on figures furnished to us in Berlin, of the German railway rolling stock before the war and in 1924. We have ignored electric locomotives and motor cars:

	Steam locomotives	Carriages	Wagons
End of 1913. . . .	27,940	62,050	657,150
January, 1924. . .	29,966	67,800	723,100

Further rolling stock ordered last year from private firms and not yet delivered amounts to: locomotives, 884; carriages, 1,453; wagons, 25,653.

Delivery of this stock was due by the beginning of May, but has been delayed owing to the occupation of the Ruhr. It is not now expected to be complete till the end of the year.

These figures show that the whole of the rolling stock handed over, either at the Armistice or together with the territory ceded under the Treaty of Peace, has been replaced by new; old and out-of-date rolling stock, which could only be replaced to a very small extent during the war, has been written off and replaced since 1920; a considerable quantity of additional rolling stock has been built.

It is worth while producing a table showing the locomotives written off and replaced for each year of the last eleven:

	Locomotives
In 1913 there were written off.....	600
In 1914 there were written off.....	379
In 1915 there were written off.....	253
In 1916 there were written off.....	237
In 1917 there were written off.....	220
In 1918 there were written off.....	167
In 1919 there were written off.....	191
In 1920 there were written off.....	690
In 1921 there were written off.....	1,849
In 1922 there were written off.....	1,585
In 1923 there were written off.....	1,500
Total.....	<u>7,671</u>

The same thing has happened with carriages and wagons. We give a table showing the new rolling stock acquired since 1914:

	Steam locomotives	Carriages	Wagons
Delivered: 1914-1918	8,859	11,832	181,196
Delivered: 1919-1923	8,506	12,313	246,388
Ordered but not yet delivered.....	884	1,453	25,653
	<u>18,249</u>	<u>25,598</u>	<u>453,237</u>

The result is that 18,249 locomotives and 478,835 carriages and wagons, two-thirds of the entire stock, have been built within the last ten years; and that accordingly the rolling stock of the German railways is much superior to that which they possessed in 1914.

Replacement of rolling stock on this colossal scale has necessarily entailed enormous expenditure. We are unable to give the actual cost, for it is spread over various budgets.

The figures which have been given to us show an expenditure, up to the end of 1922 only, of 2,267,774,488 marks.

This figure does not include the cost of replacing the rolling stock handed over to the Allied Powers in 1919, 1920 and 1921, which was paid for by special credit granted by the Ministry of Finance, amounting when reduced to gold marks to 739,347,006.

The replacement of rolling stock written off is charged against the ordinary railway budget. Additions to rolling stock are charged against the extraordinary railway budget.

From November 15, 1923 to April 1, 1924, rolling stock to an amount of 150 million gold marks will be so charged.

A further expenditure of 50 million marks in the ordinary budget and of 110 million marks in the extraordinary budget is proposed for the year 1924.

KUNZE KNORR CONTINUOUS BRAKE

The application of the Kunze Knorr continuous brake to freight trains has also implied large expenditure. It was decided in 1918, while the war was still going on, to adopt this policy in order to release a large number of brakemen, and to make possible an increase of speed of freight trains, more especially of military trains. This policy has been energetically pursued since the war; on the one hand, all the new wagons ordered have been fitted with continuous brakes, and on the other hand, the equipment of the old stock has been pushed on.

The entire program is expected to be completed by April 1, 1925. The total expenditure will amount to 400 million marks, of which 117 millions still remain to be paid. But it should be said that the Kunze Knorr Company has agreed to spread the payment over a period terminating only on October 1, 1926.

TARIFFS

Freight Tariffs

A study of the freight tariffs of any country at any time involves prolonged investigation of a vast mass of bewildering detail. To present in brief outline the broad general effect is almost impossible. Certainly the short time available has not made the task possible for us. In Germany its difficulty is increased by various special circumstances.

In 1921 the whole basis of the freight tariffs was altered by the abandonment for a large part of the traffic of flat mileage rates, and the substitution therefor of *Stafeltarife*, that is, rates under which the charge per mile decreases as the mileage increases. Simultaneously, most of the exceptional tariffs, under which the bulk of

the traffic had hitherto passed, were withdrawn. Many of them have since been restored in a modified form. And this is only the railway side of the difficulty.

The currency question complicates the whole story. Tariff advances were at the outset made in the shape of percentage increases of existing rates. Then came a period when an index figure was adopted with a varying multiplier. Finally in November, 1923, the tariffs were calculated on a gold basis. The result, as we are informed, was that the freight tariffs were found to be on a level so high in comparison with the capacity of the traffic to bear the rates, that reductions on a large scale become absolutely necessary.

We are far from satisfied that this was or is the case. We feel convinced that further investigation would support our general conclusions that the freight rates have been, and are proposed to be, reduced in a manner and to an extent which can not be justified from the railway point of view, and that this has resulted from the training and mental attitude of the officials, who have been brought up to share the views expressed in the quotation from Dr. Sarter which we have given above.

At the same time we feel it necessary to utter a note of warning. Our conclusion, that freight tariffs might be a good deal higher than the German officials think they can profitably be, is based mainly on the average receipts per ton-kilometre to-day as compared with the pre-war figures. We are told that these figures give a misleading impression of present-day facts. And numerous comparisons of certain important rates and classes of rates, pre-war and post-war, have been submitted to us, which would, if typical, put a different complexion on the matter. In spite of these tables we still adhere to the opinion we have expressed. But the Committee will appreciate that what we have said is only an expression of opinion, and can not claim to be a considered judgment based on fully ascertained statistical facts.

We have found it impossible to satisfy ourselves how high the present German freight tariffs really are. The earliest documents submitted to us stated that the freight tariffs might be assumed to be double the pre-war tariffs. The facts do not seem to us to bear out this statement. Before the war the freight charge per ton-kilometre averaged 3.36 gold pfennigs. It is estimated by the officials that in November, 1923, at the moment when the gold mark was substituted for paper marks of indefinite value as the medium of payment for railway services, the average rate was

double the pre-war. In other words, according to the official estimate, the average rate in November, 1923, should have been 6.72 pfennigs per ton-kilometre. But this is no more than an estimate, and we doubt its accuracy.

From this date there began a process which is still continuing of repeated and important reduction of rates regarded as excessive. There is statistical ground for believing that in the early part of January, 1924, the average rate was 5.89 pfennigs, an advance, that is, not of 100 per cent but of 75 per cent above the pre-war average. On January 20th a number of important reductions came into force, and the estimate, based on such statistics as were available, was in the middle of February that the then average rate was 5.55 pfennigs, an advance on pre-war rates of 65 per cent. The reductions are, however, still going on, and some of them are of great importance. On March 1st an all-round reduction of 10 per cent was made on a large part of the traffic.

The budget estimate of freight traffic receipts is made on the assumption that the average freight rate during the year will have been brought down to not more than 4.50 gold pfennigs, which is equivalent to an advance over the pre-war tariffs of only 33 per cent. No doubt this estimate errs, as was intended, on the side of caution.

On this policy we will make two observations. Taken as a whole, we have difficulty in believing that all particular reductions made and proposed can be justified. Even assuming that in certain cases reductions have been and are desirable in the interest of the railways, we feel convinced that reductions are being conceded which need not be made, and that at least in some cases the percentage of reduction is unnecessarily large. We have learned that exceptional tariffs involving great reductions, both for import of raw materials and for export of German produce, are being very freely introduced. The import rates for jute have been reduced by 25 per cent; for raw cotton and raw wool by 50 per cent. A reduction of the rate for miscellaneous wares exported by sea, amounting to 30 per cent, is on the point of coming into force; and a reduction of 30 per cent to 40 per cent in the rates for steel and iron exported by sea is contemplated.

There is a point in connection with the freight tariffs and freight revenues which, though the precise facts are obscure, is of considerable importance. The Budget estimate for 1924 assumes, apparently with good reason, that the ton-kilometres to be carried in 1924 will be roughly equal to those of 1913. But conditions have greatly

changed in the interval. The number of tons carried has fallen apparently by about 20 per cent, while the distance the average ton travels has increased in corresponding ratio. The German officials adduce three main causes for the increase in the average length of haul:

- (1) The introduction in 1921 of *Stafeltarife*;
- (2) Changes in the previous currents of traffic consequent on the war and the establishment of new political frontiers;
- (3) Diversion of traffic in consequence of the occupation of the Rhine-Ruhr territory.

The effect of (1) will be permanent; the effect of (2) will probably diminish with time; the effect of (3) will presumably be only temporary. We can not estimate what proportion of the ascertained results has been due to these three causes, respectively. But it is clear that, if in future years the tonnage does not increase, while the average length of haul goes back to anything approaching the pre-war figure, the effect on the railway revenue will be quite serious.

Before we leave the question of freight tariffs, we desire to make one observation. We have admitted that the facts are obscure; that our investigations have not been and could not be pushed very far. We have acknowledged that we have hesitated as to certain conclusions. It may well be that, where we have expressed a definite opinion, time will prove the opinion wrong.

All this we have had in mind; it does not affect the thing which from the point of view of the Committee is the really important matter, that we retain the conviction that the German railways can and should produce a net revenue of one milliard gold marks per annum available for reparation. Our forecast may well prove erroneous on certain points, too optimistic in one direction, too pessimistic in others. But our estimate is based on broader grounds than tariff details and to it we adhere.

Passenger Tariffs

The German railways have nominally four classes of passengers; but first-class carriages are not run on local trains, and fourth-class carriages are not run on express trains. The fares before the war were, respectively, at 7 pfennigs, 4.5 pfennigs, 3 pfennigs and 2 pfennigs per kilometre. In April, 1917, the transport tax, amounting to 16 per cent, 14 per cent, 12 per cent and 10 per cent on the gross receipts from the four classes, respectively, was introduced.

In spite of the tax, which is estimated to amount for 1924 to 85 million gold marks, the railway management did not raise fares till September, 1923. At this date the fares were increased, including tax, to 19.6 pfennigs, 9.9 pfennigs, 3.3 pfennigs and 2.2 pfennigs per kilometre, for the four classes, respectively. Therefore the 3rd and 4th class fares were only increased by the amount of the tax, while the 1st and 2nd class fares were more than doubled. The result of fares so obviously out of proportion was to empty the higher classes. Accordingly in December last, the 1st and 2nd class fares were reduced by one-third. But even then the 1st class fare was four times the 3rd class, and six times the 4th class. Naturally the 1st class was absolutely empty, being used by seven passengers out of 10,000, while seven passengers out of 100 travelled 2nd class. A good deal more than half the passengers travel in the 4th class, and a good deal more than one-third in the 3rd class. Seeing that a 3rd class passenger could till a few weeks ago travel 30 kilometres, and a 4th class passenger 45, for one gold mark with an ordinary ticket, and that more than half the total number of passengers, in fact, travel with season tickets issued at a rate roughly one-half of the ordinary rate—could travel, that is, respectively, 60 and 90 kilometres for one mark—it is not surprising to find it admitted that the rates for passenger traffic have been quite insufficient to cover the working expenses. At length, as from the 1st of March, while the 1st class fares have been further reduced to a level which may possibly secure a few additional 1st class passengers, the 3rd and 4th class fares have been increased by 36 per cent. The fares of the four classes are now 9 pfennigs, 6 pfennigs, 4.5 pfennigs, and 3 pfennigs, per kilometre, and the ratio between the classes is less unreasonable than hitherto.

We can hardly think that these new fares will be unduly burdensome to the German public, seeing that the German 3rd class fares per kilometre will still be only half the corresponding fare either in England or in the United States. But the public have so long been accustomed to be carried at non-commercial rates that we think some falling off of traffic is to be expected, at least at the outset. We have accordingly estimated that a 36 per cent increase in fare will only produce a 30 per cent increase in receipts.

FUTURE CONTROL—THE RAILWAY COMMISSIONER

It is evident from the facts and figures set out above, that the German government has since the war run the railways in a manner which can not be defended. On the receipts side it has failed to raise the revenue which might have been and ought to have been raised. On the expenditure side it has spent capital not merely on restoring the pre-war situation, but on betterments of all kinds which under the existing conditions can not be justified. The railways have not merely been restored to their pre-war state of efficiency, but have been brought up to a much higher standard, a standard which to the best of our knowledge is superior to that of any other country. We are given to understand that even inside the Ministry itself this policy has been severely criticised. The excuse is that the pressure on the one hand of the great manufacturers to keep their works going and to avoid a wholesale dismissal of employees, which might lead to revolts or even revolution, was too strong to be resisted; while on the other side, the poverty of the mass of the population was so great that the government was compelled to maintain railway rates at a low level. Whatever may have been the reason, there can be no doubt of the facts.

Our own view is that, while the reasons above had considerable weight, the action taken was by no means wholly due to external pressure. The officials in the tariff section of the Ministry were, as we have repeatedly said, only too ready to subordinate railway interests to non-railway circumstances. And the executive officers, whether charged with engineering or traffic management, were afflicted with what it is not too strong to describe as megalomania. They regarded it as due to the dignity of the German Reich that buildings should be magnificent, that railway plants should be up to a very high standard, that such and such services should be given, and so on. They had never been taught the commercial necessity of cutting their coat according to their cloth.

Now the mere transference of the railways from state to company management will not of itself alter this mental attitude. A large part of the Board will be German; the General Manager will be German; and his responsible officials will be the same men who have inspired and carried out the railway policy of the past. We think it therefore essential that a Railway Commissioner should be appointed by and on behalf of the Allies to supervise and, if it should hereafter become necessary, to control in their interest the German

management. We will therefore, in concluding this Report, deal with what in our opinion should be the functions of the Railway Commissioner and the organization of his staff.

THE RAILWAY COMMISSIONER

The Railway Commissioner must be a person who is acknowledged in the railway world as being in the first rank. It must be left for him, when appointed, to say what assistance he needs, in order to be able to assume responsibility for control of all branches of railway management. It will be his duty also to consider how far it is necessary to have local representatives in any or each of the districts into which the German railway system may hereafter be divided.

We assume that when appointed he will produce to the Board an outline of the organization and the staff that he regards as necessary, and it will be for the Board to approve his scheme. He must have the right to receive of course all Reports, statistical and financial returns, proposals for extra-routine expenditure, whether on capital or revenue account, for changes in tariffs or for the concession of exceptional rates and the like, when they are of such importance as would normally require the sanction of the General Manager. He must also have the right to call for any further Reports, returns and statistics, as he may think necessary, in order to enable him to form an independent judgment.

Being in possession of full and up-to-date information as to everything that is happening or is proposed, his first duty will be to decide whether to approve or disapprove. If he disapproves, or even hesitates to approve, he will discuss the matter with the General Manager. He may be of opinion that things are going wrong, or that a course of action inconsistent with the railways being able to earn a financial return is likely to be adopted. In such a case it will be his duty, if he fails to induce the General Manager to modify his policy, to bring the matter to the attention of the Board in order that they may be in a position to take such action as they think fit. It is to be hoped that, if the right man is appointed to the post, he will be able to work in entire harmony with the General Manager; and that the General Manager, so far from resenting his interference, will welcome his support in putting a stop on the one hand to unnecessary expenditure, and in enforcing on the other hand the establishment and the maintenance of tariffs proper and adequate

to secure for the railways as much net revenue as can reasonably be obtained without unduly hampering the trade of the country.

A second function of the Commissioner will naturally be to make for the foreign members of the Board reports on any points which they may regard as of serious importance. We may suggest the reasonableness of the greatly reduced German export tariffs as a sample of this class of question. It is clear that the Allied nations have a right to claim that the net revenue of the German railways should not be reduced in order to give to German manufactures an unreasonable advantage in overseas markets.

It does not seem necessary to discuss in detail what would be the position of the Commissioner if the German railways failed to yield the net revenue fixed as reasonable for reparation purposes. We assume that, broadly speaking, in this case the Commissioner General will take over the functions of the General Manager, and that, in lieu of discussing with the General Manager or recommending to the Board of Directors, he would be empowered to issue positive orders, whether for stopping expenditure which he considered unjustifiable or for an increase which he considered reasonable in existing tariffs. It is evident that it would be necessary to require the German Government to agree in advance that, if payment on the agreed scale failed to be reached or even if there was serious danger that this failure would occur in the immediate future, the Commissioner, as the representative of the Allies, should be entitled to enter into full control.

Signed: W. M. ACWORTH.
G. LEVERVE.

ANNEX No. 4

TO THE REPORT OF THE FIRST COMMITTEE OF EXPERTS

CONCESSION OF THE WORKING OF THE RAILWAYS TO A COMPANY

CONCESSION OF THE WORKING OF THE RAILWAYS

The working of the German railways shall be legally transferred to a company by a fixed date. The law will ratify the contract to be entered into between the German government and the company to which the concession is made. The contract will provide that no change can be made in the conditions of the concession without the consent of the company and the trustee for the bondholders referred to below.

The law will further provide that the company shall have a monopoly of all railway extension in Germany.

The charter of the company will be annexed to and approved by this law. Before being submitted to the German Parliament the law will have to be approved by the Reparation Commission.

The conditions under which the working of the German railway system will be transferred to the company by this law shall be as set forth below.

The company will be of German nationality.

The company shall be responsible for the working, upkeep and normal development of the railways, including rolling stock and equipment, and will be entitled, subject to the provisions hereinafter contained as to the powers of the German government and the Railway Commissioner, to conduct its business in such manner as the company may think proper.

The German government shall have such control over the tariffs and service of the railways as may be necessary to prevent discrimination and to protect the public, but such control shall never be exercised so as to impair the ability of the railroad company to earn a fair and reasonable return on its capital value, including adequate provisions for its bonds and preferred shares, a return on its ordinary shares and adequate reserves for all purposes, including amortization of capital. The plan to accomplish the foregoing shall be worked out by the Organization Committee hereinafter referred to.

The company shall as from the commencement of the concession be entitled to charge the tariffs then in force. Thereafter the company shall be entitled to vary the tariffs or any of them from time to time, subject to the provisions of Articles 365 and 378 of the Treaty of Versailles.

It shall be the duty of the Organization Committee to settle the manner in which, subject always to the preceding provision, the control of the German government over the service and the tariffs shall be exercised.

The term of the concession shall be at least of sufficient length to allow of the amortization of the bonds according to the provisions hereinafter contained. On the expiration of the concession the company shall return to the German government free from all charge, the whole of the railway undertaking, including all rolling stock and equipment, in thoroughly good and complete working order.

As the consent of the German states is necessary under the German Law of 1920 for any alienation of or charge upon the German railways, the German government shall make in this respect all necessary arrangements with the States concerned. These arrangements shall be ratified by the law granting the concession.

This law shall confer upon the company the right to mortgage any property belonging to the railways.

It shall also contain an undertaking that neither the Reich nor the States nor any public authority shall impose on the railway company any new direct tax, whether upon receipts either gross or net, or upon movable or immovable property or in respect of the employees of the company or otherwise howsoever.

THE RAILWAY COMPANY

ARTICLE I

CAPITAL OF THE COMPANY

The total capital which will be created, added to the first mortgage bonds for eleven (11) milliard marks gold referred to below, will correspond to the capital cost of the German railway system (26 milliard marks gold).

Preference shares will be created to the amount of 2 milliard gold marks, bearing a fixed rate of dividend and entitled to participation in the profits of the railways, after payment of the annual payments mentioned below. This dividend and this participation as also the terms on which the German government may pay off or repurchase these shares, will be fixed by agreement between the German government and the organization Committee described below.

These preference shares will be sold by the company for the profit of the German government and of the company itself; one-fourth ($\frac{1}{4}$) of the sum thus obtained will be the property of the German government and three-fourths ($\frac{3}{4}$) the property of the company. The sales of shares will be made under such conditions that the German government will receive the whole sum due to it within two years. If the German government so requires, the proceeds of the first sale of shares may be reserved for its use.

The balance of the capital cost of the German railway system (viz., 13 milliard gold marks) will be represented by ordinary shares, to be owned by the German government and to be kept or sold by it as it prefers.

ARTICLE II

ADMINISTRATION AND MANAGEMENT

The company will be administered by a Board of Directors of at least eighteen (18) members, who shall all be business men of experience or railway experts. Half ($\frac{1}{2}$) of these will be appointed

by the German government and half by the Trustee referred to below.

As soon as preference shares are issued to the public, the holders of these shares shall be entitled to elect four members of the Board in place of four members appointed by the German government.

The Organization Committee will also fix the duration of the term of office of the Directors of each class.

Of the nine (9) members of the Board of Directors appointed by the Trustee, five (5) may be German nationals.

The Chairman of the Board will be elected for one year by a three-fourths' ($\frac{3}{4}$) majority of the members of the Board and will be eligible for re-election as long as he possesses the necessary qualifications.

As soon as the preference shareholders shall elect directors, the Chairman shall be chosen from the Directors so elected.

He will, in addition to his vote as a member of the Board, have a second or casting vote.

The General Manager of the company shall be of German nationality.

He will not be eligible for a seat on the Board. He will be appointed by a three-fourths' ($\frac{3}{4}$) majority vote of the Board.

He may be removed by the same majority. If, however, his removal is requested by the Commissioner (provided for in Article III below) on account of violation of the charter of the company or of failure to comply with the instructions of the Board of Directors, he may be removed by a simple majority vote of the Board.

Whatever decisions may be taken with regard to the operation of the railways it must be understood that any breaking up of the working of the system into local divisions must not in any event affect the financial and tariff unity of the undertaking.

ARTICLE III

COMMISSIONER

The Railway Commissioner shall be a person accepted in the railway world as being in the front rank.

He shall be appointed by a majority vote of the foreign members of the Board of Directors.

He shall not be a member of the Board.

He will have an adequate staff of experts in railway matters and in accountancy.

The Commissioner will have a general right of inspection over the whole railway system and all the railway installations and subdivisions, either in person or by deputy.

He shall also be entitled to receive all reports, statistical and financial returns, proposals for extra-routine expenditure whether on "capital" or "revenue" account, for changes in tariffs or for the concession of exceptional rates, and the like, which are of such a nature as would normally require the sanction of the General Manager.

The Railway Commissioner will further be entitled to call for any other reports, returns, or statistics which he may consider necessary in order to enable him to form an independent opinion. All this information shall be furnished promptly, fully, and accurately at his request. If any measure in connection with construction, operation, or tariffs tends substantially to menace the rights or interests of the bondholders or of the Reparation Commission, as defined below, and in particular to endanger the payment at the due dates, referred to in Article V below, he shall discuss the question with the General Manager. If he can not persuade the latter to change his line of conduct, he must lay the question before the Managing Board, in order that it may take any measures it may deem necessary.

If the service of the bonds hereinafter mentioned is in jeopardy, the Commissioner shall have regard to the provisions for the security of the bondholders hereinafter contained.

The expenses of the Railway Commissioner and his staff shall be an operating charge upon the receipts of the railways.

ARTICLE IV

BONDS

The company shall forthwith, after its creation, issue without payment and for the purpose of reparation, to a Trustee appointed by the Reparation Commission, first mortgage bonds to a nominal amount of 11 milliard gold marks carrying interest at 3 per cent per annum for the first financial year of the company, at 4 per cent plus a bonus of 25 millions for the second, 5 per cent for the third and

subsequent years, and to be amortized by a sinking fund as hereinafter provided.

Payment of these bonds shall be guaranteed by the German government and they shall be signed both on behalf of the company and by the Finance Minister acting on behalf of the German government.

These bonds shall be secured by a first registered mortgage or charge on the corpus and revenues of all immovable property used by or belonging to the company present or future, and by a first floating charge on all its fixed and movable plant, rolling stock and all installations. The company shall be authorized by the concession to create this mortgage and charge, the duration of which shall not be limited to the period of the concession.

This mortgage and this first floating charge shall be expressed to be in favor of the Trustee to be appointed by the Reparation Commission, provided always that the company and the German government shall be entitled at any time, with the consent of the Trustee, to sell or dispose of any particular property used by the railway company which may be considered to be no longer needed by the latter, upon such terms as to the application of the proceeds of the sale as may be agreed upon by the Trustee.

The service of the bonds shall be assured by the following payments which shall be made to the Trustee from the gross receipts of the company and before the ascertainment of any net profits; that is to say:

	Million gold marks
a. For the first financial year of the company . .	350
b. For the second financial year.....	465
c. For the third financial year.....	550
d. For the fourth and subsequent financial years	660

If in any year the German railways fail to realize receipts sufficient to allow of the payments above mentioned (it being understood that the company may draw upon whatever reserves may be available for this purpose until such reserves are exhausted), the Railway commissioner shall have the right to take such action as the Trustee for the bondholders may consider is necessary to protect the rights of the bondholders, including the right to operate, to lease, or to sell all or any of the railways and property subject to the mortgage or charge of the bonds.

From and after the end of the fourth year from the date of the formation of the company, the bonds shall be amortized, under the conditions to be determined by the Trustee with the approval of the Reparation Commission, by the application in each year of such part of the annual payments above mentioned as shall not be required for the interest on the bonds.

The German government and the company shall also be entitled at any time to pay to the Trustee sums additional to the above payments with the authorization of the Reparation Commission which shall ascertain from the Transfer Committee that the transfer of these additional funds does not disturb the transfer of the annual payments. Any sums so paid shall be applied first to the discharge of any interest in arrear and next upon six months' public notice in redeeming at par all or any part of the bonds for the time being outstanding.

The Reparation Commission shall be entitled, with a view to the mobilization of the bonds, to divide the same in any manner which it may think expedient into different classes with different rights—as to priority of charge, rate of interest, repayment of capital and otherwise—against the annual payments to be made by the company, and to issue to the public upon such terms and generally in such manner as the Commission may think proper, bonds, debentures, debenture stock, certificates of indebtedness or other securities of any nature secured upon the whole or any part of the bonds.

The company shall not be able to issue other bonds than those referred to above without the authorization of a three-fourths' majority of the members of the Board, of which majority two must be foreigners.

All payments of interest and capital in respect of the bonds shall be free from all German taxation except in so far as the persons entitled thereto may be liable under German law to the payment of German direct taxation.

Subject as herein provided the form of the said bonds and all provisions as to the enforcement and repayment thereof including drawings and giving time for payment shall be settled by the Trustee with the approval of the Reparation Commission.

ARTICLE V

ENFORCEMENT OF GOVERNMENT GUARANTEES

If the company shall at any time make default in meeting the service of the bonds, the Trustee may in lieu of or in addition to the measures mentioned in the last preceding Article present the accrued coupons or any bonds due for repayment to the Commissioner of Controlled Revenues who shall pay them at their face value out of the portion of the receipts of the assigned revenues falling to the share of the German government. The coupons and bonds so paid shall be included at their face value in the repayments made by the Commissioner of Controlled Revenues to the German government. The amounts so paid may only be repaid by the company to the government after the necessary provision has been made for the current and the next coupons on the bonds and for the fixed dividend for the current year on the preference shares.

ARTICLE VI

TRANSPORTATION TAX

The company shall on behalf of the government pay to the Reparation Commission the proceeds of the transportation tax as at present levied, i.e., a tax of 7 per cent on the gross receipts from all freight traffic other than coal, and a tax of 10 per cent to 16 per cent according to class, on the gross receipts from all passenger traffic. This payment shall be made during the first and each of the following years of the concession and until the conclusion of any extension, even if in the course of the concession the whole of the bonds have been paid off.

The rate of the transportation tax shall not be reduced during the whole of the concession. The proceeds of the tax may be employed by the trustee to secure the issue of a special series of bonds for 3 milliard gold marks, or thereabouts.

ARTICLE VII

FINANCIAL ARRANGEMENTS

The bank account shall be kept at the new Bank. Payments by the company hereinbefore prescribed shall be paid to the account of the Railway Commissioner. The latter shall transfer these sums to the credit of the agent for reparation payments.

ARTICLE VIII

ANTICIPATORY REDEMPTION OF BONDS

If all the first mortgage bonds should be redeemed before the expiration of the term of the concession by special subsidy by the German government to the company, the government shall be entitled to require that the functions of the Railway Commissioner hereinbefore mentioned shall come to an end and that the foreign directors shall be replaced by German directors. In default of other arrangements, the transportation tax shall continue to be paid to the Reparation Commission.

The German government shall in that case also have the right to purchase or repurchase the preference shares at par, plus dividend and arrears of dividend if accrued.

ARTICLE IX

ORGANIZATION COMMITTEE

A temporary Committee with the title of the "Organization Committee of the German Railway Company" shall be constituted in order to work out, subject to the foregoing provisions, the details necessary for the creation of the German railway company and the execution of this plan. The Committee shall consist of two delegates appointed by the German Minister of Railways, the railway specialists, Sir William Acworth and M. Leverve, who are familiar with the discussions which have led to the adoption of this scheme, or a nominee or nominees to be appointed by them jointly together with a fifth member of neutral nationality to be chosen by the four

thus appointed, or, in default of such choice, to be appointed by the Reparation Commission.

This Organization Committee will come to an end as soon as may be after the railway company has been constituted, the Railway Commissioner appointed and this plan has been put into operation. The expenses of the Committee and of their staff shall be an operating charge upon the receipts of the German railways.

ARTICLE X

ARBITRATION

The law to be enacted by the German Parliament shall provide that so long as the functions of the Railway Commissioner hereinbefore mentioned shall not have come to an end, if any dispute or difference should arise between the Reparation Commission or any government represented thereon, on the one side, and the company and the German government, or either of them, on the other side, or between the company and the German government, as to the interpretation of any provision of the said law, or of the charter of the company, or of this plan, or as to anything to be done under any of them, respectively, whether in respect of the capital and obligations of the company or of its external, or internal management, or otherwise howsoever, the same shall be referred to the decision of an arbitrator who, if the German government so desires, shall be of neutral nationality to be nominated by the President for the time being of the Permanent Court of International Justice, and the decision of the arbitrator so appointed shall be final.

ANNEX No. 5

TO THE REPORT OF THE FIRST COMMITTEE OF EXPERTS

PLAN FOR INDUSTRIAL DEBENTURES

THE AMOUNT AND FORM

I. The German government shall provide bonds or debentures of industrial concerns to a total nominal value of five (5) milliards of gold marks, bearing five per cent (5 per cent) interest and one per cent (1 per cent) for sinking fund per annum. These bonds shall be the individual obligations of the several concerns and shall be secured as to principal, interest, and sinking fund payments by a first mortgage on the plant and property of the respective concerns making them.

The term "industrial concerns" shall include not only manufacturing concerns, but navigation, mining and any other similar concerns which the Organization Committee may indicate.

DELIVERY TO TRUSTEE

II. The mortgage bonds or debentures above provided for, with suitable coupons covering the interest payments, shall be delivered by the German government to the Trustee to be appointed by the Reparation Commission, who will hold them, collect the coupons thereon, paying the proceeds into the account of the Agent for reparation payments, or dispose of them in whole or in part from time to time under the orders of the Reparation Commission. The debtor may make proposals to the Trustee for their immediate

or gradual redemption, and the Committee recommends that the Trustee be empowered, to give preference to such proposals of redemption and especially those of which the redemption would be effected by the use of foreign currencies, before offering such bonds in the open market or otherwise. In the event that no proposals of a satisfactory plan of redemption are made to the Trustee by any individual maker of the bonds within six months after such bonds shall have been delivered to him by the German government, then the Trustee in his discretion, but with due regard to the protection of the credit of the debtor, shall be free to dispose of the same in such manner and on such terms as the Reparation Commission may authorize.

GUARANTEE BY GERMAN GOVERNMENT

III. The German government shall guarantee the principal, interest and sinking fund payments on such bonds; in consequence, in case of default the matured coupons can be presented to the Commissioner of Controlled Revenues, who shall purchase them at their nominal value, by means of the funds under his control which are destined to be paid over to the German government. The Commissioner will include the coupons for their nominal value in the "reversements" to the German government, which will have recourse against the defaulting debtor.

The German government might, by means of subsidies, encourage the repurchase of the bonds by the mortgagors and thus free itself from its guarantee.

TAX-EXEMPTION PROVISION

IV. The said bonds and mortgages until redeemed shall be exempt from taxation in Germany, unless they shall be held by German nationals, in which case they shall be taxed like other similar bonds and mortgages so held by German nationals and without discrimination.

TEMPORARY ORGANIZATION COMMITTEE

V. A temporary Organization Committee shall be formed for the purpose of taking all necessary measures within the scope of the foregoing plan and for fixing the details of organization. This Committee shall include a representative of the German government,

a representative of industry, two members appointed by the Reparation Commission and a fifth member of neutral nationality to be chosen by the four thus appointed, or in default of such choice to be appointed by the Reparation Commission.

POWERS OF THE ORGANIZATION COMMITTEE

VI. A. The Organization Committee shall have all powers to work out the details of the plan in such form as may be fair alike to the German government, to the industrial concerns and to the Reparation Commission, bearing in mind that it is the purpose and intent of the plan to ensure for reparations account the payment of the 5 milliards of gold marks with interest thereon at 5 per cent per annum and a sinking fund of not less than 1 per cent thereon, which in and of itself will determine the maturity of the bonds.

B. The Organization Committee shall have the power to determine the form and character of the mortgages, and, in case the concerns are too small to make individual mortgage issues practical and desirable, the Committee shall have power to devise some method of handling them, or may waive them altogether, provided the total sum of 5 milliards is maintained.

ANNEX No. 6

TO THE REPORT OF THE FIRST COMMITTEE OF EXPERTS

THE TRANSFER OF REPARATION PAYMENTS FROM GERMAN CURRENCY INTO FOREIGN CURRENCY AND THE USE OF BALANCES NOT TRANSFERRED

TRANSFER COMMITTEE

I. The plan provides that all payments for the account of reparations, however derived, are to be first made in the form of deposits in the Bank, provided for in the plan, to the credit of "The Agent for Reparation Payments." The withdrawals from this deposit shall be made by the Agent for Reparation Payments only, under the direction of a Committee composed of five members known as "The Transfer Committee."

COMPOSITION AND SELECTION OF MEMBERS

II. The Transfer Committee shall be composed of six members; the Agent for Reparation Payments shall be a member and the Chairman; the other five members shall be persons qualified to deal with foreign exchange questions. They shall consist of an American member, a French member, an English member, an Italian member and a Belgian member. Each of them shall be appointed by the Reparation Commission, after the member of the General Board of the Bank of the same nationality has been consulted.

COOPERATION OF THE BANK

III. The Committee will be in contact with the President and the Commissioner of the Bank.

POWERS OF THE COMMITTEE

IV. The Committee shall have power, and it shall be its duty:

a. To apply such bank balances for payments for deliveries in kind and payments under the Reparation Recovery Act, in accordance with the program established periodically by the Reparation Commission, after consultation with the Transfer Committee as to the character and amount of such deliveries;

b. To convert these bank balances into foreign currencies from time to time and, after conversion, to remit them in accordance with the instructions of the Reparation Commission.

Both the foregoing powers *a* and *b* to be exercised to the extent to which in the judgment of the Committee the foreign exchange market will permit, without threatening the stability of the German currency.

c. To invest from time to time in bonds or other loans in Germany such amounts as the Committee may deem wise. The Committee shall proceed to make these investments as soon as the amount of the credits exceeds the sum which the Bank will keep on deposit. On the other hand, the Committee may sell the bonds which it has acquired, or liquidate the loans which it has granted, whenever in its opinion the sums may be converted into foreign exchange, or the Bank can accept additional deposits.

RESTRICTION ON PURCHASE BY THE CREDITORS

V. The goods supplied by Germany to the creditor countries under paragraph IV *a* above and paid for by the Bank as above provided, shall be for the sole use of the countries receiving them for their internal requirements, including the requirements of their colonies and dependencies. The goods so delivered shall not be exported from the country receiving them, except by agreement between the Committee acting unanimously and the German government.

VI. In addition to its powers under paragraph IV, the Committee

may on the instructions of the Reparation Commission and at the request of the creditor States, by debiting their accounts, transfer marks to private individuals for the purpose of making purchases in Germany, such reinvestment not to be of a temporary character, and such property being of classes contained in a schedule agreed to between the Committee and the German government, and modified from time to time by similar agreement. In arriving at such agreement, the German government shall be required to have due regard to the necessity for making maximum payments to its creditors, but it shall also be entitled to have regard to maintaining its control of its own internal economy.

COOPERATION BY THE GERMAN GOVERNMENT AND THE BANK

VII. The German government and the Bank shall undertake to facilitate in every reasonable way within their power the work of the Committee in making transfers of funds, including such steps as will aid in the control of foreign exchange. When the Committee is of the opinion that the Bank's discount rate is not in relation to the necessity of making important transfers, it shall inform the President of the Bank.

ATTEMPTS TO DEFEAT TRANSFER

VIII. In the event of concerted financial manœuvres either by the government or by any group, for the purpose of preventing such transfers, the Committee may take such action as may be necessary to defeat such manœuvres; and in such circumstances it may suspend the operation of paragraph X, may accumulate the funds or employ them in the purchase of any kind of property in Germany.

TAX-EXEMPTION PROVISION

IX. The German government shall not tax the deposits in the Bank or goods purchased for the creditor countries pending removal, nor any securities or loans representing investment of funds pending transfer, nor any property purchased under the provisions of the paragraph next preceding. This exemption does not apply to property purchased under paragraph VI, but, on the other hand, there should be no tax discrimination against such property.

PROVISIONS FOR LIMITATION OF ACCUMULATION

X. *a.* When the accumulation of funds not transferable under the provisions of subdivisions *b* and *c* of paragraph IV shall have reached the sum of five (5) milliard gold marks (whether represented by bank deposits or loans) the payment for Treaty charges provided for shall be reduced to such an amount as will cover the transfers and payments provided for under subdivisions *b* and *c* of paragraph IV without additional accumulation. Such partial suspense of Germany's obligations shall be operative only during the period that the conditions of transfer necessitate, and the standards of payment laid down in the plan shall be resumed at any time when they can operate without the limits of accumulation herein laid down being exceeded.

b. The Committee shall have power to suspend accumulation before reaching five (5) milliard gold marks, if two-thirds ($\frac{2}{3}$) of its members are of the opinion that such accumulation is a menace to the fiscal or economic situation in Germany or to the interests of the creditor countries.

c. The Committee shall, by a two-thirds' ($\frac{2}{3}$) majority, have power to waive the limit accumulations under the conditions provided for in paragraph VIII.

ANNEX No. 7

TO THE REPORT OF THE FIRST COMMITTEE
OF EXPERTS

NOTE ON THE CURRENCIES CIRCULATING IN GERMANY
IN JANUARY, 1924

CHAPTER I

Paper Mark Currency

A. LEGAL TENDER

1. *Reichsmarks.* Reichsmarks are issued by the Reichsbank under a privilege granted to it by the Banking Law of March 14, 1875. In 1913, the circulation of paper marks amounted to 2.1 milliards; on *January 31, 1924*, it had reached the figure of 483.7 trillion (English) paper marks representing *483.7 million gold marks* at the rate of 1 gold mark = 1 billion paper marks.

2. *Notes of private banks.* Banks, which at the time of the promulgation of the Law of March 14, 1875, had the right to issue notes, have retained this privilege. The number of these banks, which was originally thirty-two, has decreased progressively; at the present time there are only four private banks, namely:

BAYERISCHE BANKEN,
SÄCHSISCHE BANK,
BADISCHE BANK,
WURTEMBERGISCHE NOTENBANK.

NOTE.—In the English text of this document the English system of numeration is followed throughout.

The total circulation of notes issued by these four institutions amounted in 1913 to 140 million gold marks. At the end of January, 1924, it represented about 100,000 gold marks.

3. *Reichskassenscheine*. These currency notes were issued at the time of the formation of the Reichsbank (1875) in order to make it possible to place the fiduciary circulation on a sound basis by means of the withdrawal of the State notes then in circulation. The issue was originally fixed at 120 million gold marks, corresponding exactly to the war treasure (in gold) deposited at Spandau. The circulation, which reached the figure of 320 millions in 1920 progressively decreased until August, 1923, when it still amounted to 200 million gold marks. At that date the Reichskassenscheine in circulation were completely withdrawn.

4. *Darlehenskassenscheine*. (Bonds issued by the Darlehenskassen during the war). The issue reached its maximum figure in October, 1922 (14 milliard paper marks); these bonds ceased to figure in the statements as from August, 1923, when the circulation amounted to only 11 milliard paper marks, corresponding to less than 10,000 gold marks.

B. AUXILIARY INSTRUMENTS OF PAYMENT

1. *Issue of secured Notgeld*. The issue of Notgeld (emergency currency) was regulated by the Law of July 17, 1922. This currency was issued with a view to supplementing that issued by the Reich, the Reichsbank and the private banks of issue, the total value of which in circulation was constantly decreasing as a result of the fall of the mark. The previous authorization of the Minister of Finance was necessary. The Notgeld was to be secured by a deposit in fixed values, *earmarked* in favor of the Reich Minister of Finance, and corresponding to the amount placed in circulation, less the actual or estimated expenses of issue. This asset was to remain at the Reichskreditanstalt at Berlin, which would allow interest at 2 per cent less than the rate of discount of the Reichsbank. The cover for the Notgeld might also consist of three months' Treasury Bonds; but in this case, it was the Reichsbank which would issue the Notgeld and accept the deposit in Treasury Bonds offered as guarantee.

Authorization to issue Notgeld was granted to public and private organizations for a total figure, which at the end of 1923 amounted

to 7.6 trillion paper marks, corresponding to 7.6 million gold marks. The circulation of this Notgeld amounted on *December 31, 1923*, to 3.4 trillion paper marks, that is, *3.4 million gold marks*. An endeavor has since been made to withdraw the Notgeld from circulation; a decree of January 2, 1924, prescribed the complete withdrawal in certain unoccupied territories. On *January 31, 1924*, the circulation amounted to 1.4 trillion paper marks, or *1.4 million gold marks*.

2. *Issue of unsecured Notgeld.* Numerous emergency currencies have been issued without authorization from the German government, and without the formation of a guarantee deposit, both by public and private organizations and even by private individuals.

The amount of this Notgeld issued without authorization or guarantee and in circulation at the end of January, 1924, is estimated by the German government as follows:

	Million gold marks
a. In unoccupied territory.....	27.6
b. In occupied territory.....	132

3. *Railway Notgeld.* In order to cover the working deficit the Reich railways issued 114 trillion paper marks during 1922 and 1923. This currency was secured by a Reich deposit at the Reichsbank of 90 million Rentenmarks. At the end of January, 1924, 56 millions were still in circulation.

CHAPTER II

Instruments of Payment in Gold or at a Fixed Value

1. *Rentenmark.* The Rentenbank was created by the Decree of October 15, 1923. The method of creation and operation is known.

The issue of notes in Rentenmarks began on November 15, 1923.

According to the balance sheet of the Rentenbank on January 31, 1923, the amount issued at that date was 1,374 million Rentenmarks.

The introduction of the Rentenmark has stopped the issue of Notgeld of fixed value.

2. *Dollar Treasury Bonds (Dollarschatzanweisungen)*. The Law of March 2, 1923, authorized the issue of Dollar Treasury Bonds for a total amount of 50 million dollars (210 million gold marks). These Bonds, issued in denominations of from 5 to 100 dollars, do not bear interest, but are redeemable in gold at 120 per cent, on April 15, 1926.

These Treasury Bonds have been fully subscribed. They have been used in Germany as a means of payment.

3. *Gold Loan (Wertbeständige Anleihe)*. This loan authorized by the Law of August 14, 1923, is for a total sum of 500 million gold marks, which has been fully subscribed. The bonds are expressed in dollars. The small denominations of from $\frac{1}{10}$ th to 5 dollars do not bear interest and are redeemable at 170 per cent on September 2, 1935. Bonds for 10 dollars or more bear 6 per cent interest and are redeemable at par on the same date. These large denominations were issued first for a total sum of 164 million gold marks. Subsequent issues of large denominations raised this figure to 204 million gold marks.

In October, 1923, the monetary situation having become intolerable on account of the fall of the paper mark, and wage earners having insisted upon being paid in currency of fixed value, the Reich decided (the preparations for the issue of the Rentenmark not being sufficiently advanced) to issue small denominations of the gold loan.

These small denominations were issued up to a total amount of 296 million gold marks, 4 millions of which were exchanged against Rentenmarks in January, 1924, in accordance with the privilege granted to the holders in this respect.

As will be seen later, 10 millions of this gold loan have been assigned as partial security for the Notgeld of a fixed value issued by the Railways.

At the end of January, 1924, therefore, the circulation was as follows:

	Million gold marks
Large notes.....	194
Small notes.....	292
Total.....	486

4. *Notgeld secured by six per cent Treasury Bonds (6 per cent Schatzanweisungen)*. Since the small gold loan certificates proved

insufficient for the monetary circulation, the provinces, towns, chambers of commerce and the larger industrial undertakings were given authority to create emergency currency on a gold mark basis, to be covered by gold loan certificates of large denominations. Owing to the scarcity of the latter, the authorities issuing Notgeld were given permission to provide cover in the form of 6 per cent Treasury Bonds expressed in dollars and gold marks, specially created for this purpose by the decree of October 20, 1923. These Bonds fall due on December 1, 1932, and are redeemable at par in German currency on a gold basis.

The total amount of Notgeld thus secured (exclusive of the Notgeld issued by the railways and to which we will refer later) stood at 110 million gold marks on January 31, 1924.

This Notgeld is to be gradually withdrawn from circulation against redemption in loan bonds or German currency. Redemption was to begin on January 15, 1924, and it is hoped that the full amount will have been called in not later than April 1, 1924.

5. *Treasury Bonds and interim bonds issued by the States.* Certain States issued fixed value loans, some of the certificates for which were of such small denominations that they still serve as instruments of payment. The total value of these bonds amounts to about 50 million gold marks. Attempts are being made to recall these small denominations by converting them into larger denominations.

6. *Certificates issued by the banks of Hamburg and Schleswig-Holstein.* Two banks, the Hamburger Bank von 1823 A. G. and the Schleswig-Holsteinische Goldgirobank A. G. were authorized by the Reich Minister of Finance to deliver, in exchange for currencies, "discount certificates" (Verrechnungsscheine) which still serve as instruments of payment. It is the intention of the German government to dispense with these gold certificates as soon as a gold currency has been reinstated. The Hamburger Bank issued certificates to the amount of 25 million gold marks. No particulars are available regarding the amount issued by the Schleswig-Holsteinische Goldgirobank but the figure is inconsiderable.

7. *Notgeld issued by the railways.* In order to cover their deficit the German railways were authorized to issue, in addition to the paper mark Notgeld referred to above, Notgeld having stable value to the amount of 200 million gold marks. Ten millions of this issue were secured by gold loan bonds as explained above, the remaining 190 millions being secured by 6 per cent Treasury Bonds as already stated. The Notgeld issued by the railways amounted to

131.9 millions on January 31, 1924. This emergency currency is to be withdrawn from circulation by means of a loan to be issued later by the railways.

**TABLE OF INSTRUMENTS OF PAYMENT IN CIRCULATION
IN GERMANY IN JANUARY, 1924**

	Approximate value ¹ in millions of gold marks
I. Instruments of payment expressed in paper marks:	
1. Reichsbank notes (as per return dated January 31, 1924),	483.7
2. Notes of the four private banks of issue.	0.1
3. Notgeld issued by the railways and secured by a deposit of 90 million Rentenmarks at the Reichsbank	56.0
4. Notgeld issued against the deposit of security in currencies.	1.4
5. Notgeld issued without cover:	
<i>a.</i> In occupied territory.	132.0
<i>b.</i> In unoccupied territory.	27.6
Total I.	700.8

¹ Calculated on the basis of 1 gold mark equals 1 billion paper marks.

	Approximate value ¹ in millions of gold marks
II. Instruments of payment expressed in gold or having fixed value:	
1. Rentenmarks (as per Rentenbank return of January 31, 1924)....	1,374.0
2. Dollar Treasury Bonds (Dollarschatz- anweisungen, law of March 2, 1923).....	210.0
3. Gold Loan (Wertbeständige Anleihe, law of August 14, 1923).....	486.0
4. Notgeld secured by 6 per cent Treas- ury Bonds (6percent Schatzan- weisungen, law of Oct. 20, 1923)	110.0
5. Treasury Bonds and interim bonds issued by the States.....	50.0
6. Certificates issued by the Banks of Hamburg and Schleswig-Hol- stein (Verrechnungsscheine)...	35.0
7. Notgeld issued by the railways and secured by 6 per cent Treasury Bonds (10 millions of which are secured by gold loan).....	131.9
Total II.....	2,396.9
III. Denominational currency in Rentenpfennigs	158.0
Grand total.....	3,255.7

¹ Calculated on the basis of 1 gold mark equals 1 billion paper marks.

NOTE.—This total does not include the foreign currencies at present in Germany which, according to the estimate made by the second Committee of Experts would amount to 1,200 million gold marks, a figure which has been confirmed by a German authoritative source.

ANNEX No. 8

TO THE REPORT OF THE FIRST COMMITTEE
OF EXPERTS

PROVISIONAL " SURVEY OF THE BUDGET FOR 1924

Revenue	In millions of		Expenditure		In millions of	
	Gold marks	£	£	\$	Gold marks	£
I. GENERAL ADMINISTRATION OF THE REICH						
A. ORDINARY BUDGET						
1. Taxes on property, traffic, trade and transfer (direct taxes)	4,004	200.2	1,001.0		156	7.8
2. Custom and excise duties (indirect taxes)	1,080	54.0	270.0		810	40.5
3. Non-tax Revenues from Public Services	60	3.0	15.0		450	22.5
					208	10.4
					28	1.4
					500	25.0
					360	18.0
					380	19.0
					250	12.5
					1,800	90.0
Total of ordinary revenues	5,144	257.2	1,286.0		4,942	247.1
						1,235.5
B. EXTRAORDINARY BUDGET						
1. Revenue from the Mint	90	4.5	22.5		6	0.3
2. Other revenues	40	2.0	10.0		44	2.2
					20	1.0
					60	3.0
Total of extraordinary revenues	130	6.5	32.5		130	6.5
Total of A and B	5,274	263.7	1,318.5		5,072	253.6
						1,268.0

II. EXECUTION OF THE TREATY OF VERSAILLES

1. Cash Rep. Payments..... (Discharge of debt due to the Reichsbank for re- demption of an exchequer bill given to Belgium).	52	2.6	13.0
2. Clearing Office payments....	6	0.3	1.5
3. Cost of Armies of Occupa- tion.....	360	18.0	90.0
4. Rhineland Commission....	34	1.7	8.5
5. Other Inter-Allied Commis- sions including Repara- tion. Commission.....	18	0.9	4.5
6. Restitution, substitutions and dismantlement costs..	10	0.5	2.5
7. Home expenditure incurred by the carrying out of the Treaty of Versailles..	160	8.0	40.0
Total of expenditure..	640	32.0	160.0

BALANCE

I. General Administration of the Reich.....	5,072	253.6	1,268.0
II. Execution of the Treaty of Versailles.....	640	32.0	160.0
Total of expenditure.....	5,712	285.6	1,428.0
Revenues.....	5,274	263.7	1,318.5
Deficit.....	438	21.9	109.5

^a The figures of this table can only serve as a preliminary estimate and are given with all reserve. This estimate of the revenues assumes complete restoration of economic unity between occupied and unoccupied territory, renewed administrative and fiscal supremacy in occupied territory on the part of the Reich and the component States, that the taxes to be levied according to the general laws of the Reich and the States are once more directed into their Treasuries.

ANNEX No. 9

TO THE REPORT OF THE FIRST COMMITTEE OF EXPERTS

COMPARATIVE POSITION OF DIFFERENT INCOMES DRAWN FROM DIVIDENDS IN THE YEARS 1920-21, 1923-24 AND 1924-25

QUESTION SUBMITTED TO THE GERMAN GOVERNMENT BY THE FIRST COMMITTEE OF EXPERTS

Assume four men with incomes in gold marks, 15,000, 100,000, 500,000, 1,000,000:

- a. Wholly from dividends of German industrial companies;
- b. One-half from German and one-half from foreign companies.

What amount of income tax (or its substitutes) plus capital tax will be payable on the scales for 1920-21, 1923-24, 1924-25 respectively?

REPLY OF THE GERMAN GOVERNMENT

For the following reasons it is impossible to make reliable estimates of the kind desired:

1. Because the fiscal burden for 1920-21 can not be calculated owing to the influence of the depreciation of the currency;
2. Because no assessment exists for 1923 based on sliding-scale rates for that year; indeed for 1923 prepayments and payments of balance were collected which were regularly calculated on a coefficient of the 1922 taxes and were therefore not entirely immune from the influence of the depreciation of the currency;
3. Because no income tax levied on a sliding scale exists so far for 1924; the prepayments for 1924 are collected more according to external standards; the actual income for 1924 will not be assessed

until 1925, when it will be based upon a tariff which will be determined by law in the course of the year 1924.

Particulars concerning the form of the taxes will be found in the memorandum transmitted (see for 1920-21—the English text, pages 81, 96; French text, pages 81, 97; for 1923-24—English text, pages 83-84, 96; French text, pages 84, 97). Reference should be made to the statement concerning the Budget estimates of the Wages Tax and the prepayments on the Income and Corporation Taxes for 1924 transmitted as V a II 1480, of February 16, 1924.

It should further be pointed out that income from dividends to the amount mentioned existed in Germany before the war to a limited extent only and is unlikely to be found after 1922, owing to economic developments during the period of depreciation of the currency.

As early as 1920 there were only six taxpayers in Germany who had an income from investments of from 3 to 10 million paper marks, that is, from 200,000 to 667,000 gold marks and sixty-six with an income from investments of from 1 to 3 million paper marks, that is, about 67,000 to 200,000 gold marks. From about the middle of 1922 income from investments had practically disappeared.

In view of the circumstances mentioned above, any estimates are attended with exceptional difficulties. An attempt is made below to employ available bases for valuation as required in the Questionnaire.

The estimates given in the enclosed table showing the charge on incomes from dividends of 50,000, 100,000, 500,000 and 1 million gold marks fulfil the conditions set forth in the Questionnaire.

a. That the whole income is drawn from dividends of German industrial companies;

b. That half the income is drawn from German and half from foreign industrial companies.

It was necessary in drawing up this table to include in the calculation of the charges on income derived from dividends of German industrial companies, the taxes which had to be paid by the German companies if they distributed dividends to the amounts in question; it must not be forgotten that this tax is deducted before the distribution of the dividends. In converting the income in gold into paper marks and the taxes in paper marks into gold marks the rate of the dollar has been used as the basis. This was possible because the income is indicated in gold and therefore the calculation of the tax at the dollar rate affords a basis for comparison.

In making the calculation the following assumptions have been made:

I. *For 1920-21.* The dividend has been paid to the taxpayer in 1920. The tax paid by the company has first been deducted from the profits which the company made in 1919 and on which it paid the tax in 1920. A further prior charge consists of the 10 per cent tax on revenue from capital which was deducted from the German dividends of the taxpayer at the time of their receipt in 1920 and which he paid in 1921 for his foreign dividends. From the remaining revenue, after deduction of the tax on revenue from capital, the taxpayer has paid his income tax for 1920 according to schedule. In estimating the actual fiscal burden, account has been taken of the fact that the income was obtained in the year 1920, that the corporation tax and the tax on revenue from capital were paid at the time of receiving the dividends, that is also in 1920, and that on the other hand the tax on revenue from capital in respect of foreign dividends and the income tax were not paid until 1921, and were therefore paid in a depreciated currency. On the basis of the average dollar rate, one gold mark was in 1920 equivalent to 15 paper marks, and in 1921 to 24.9 paper marks.

Example 1. Let us assume the income from dividends in German companies in 1920 to be 50,000 gold marks=750,000 paper marks. Before distributing 750,000 paper marks a company in 1920 had to pay an average tax of 127,500 paper marks. The 750,000 paper marks due to the person receiving dividend were, upon receipt, reduced by 10 per cent, that is, by 75,000 paper marks. In 1920, therefore, 202,500 paper marks were paid in taxes=13,500 gold marks. From the remaining 675,000 paper marks he had to pay the sum of 356,600 paper marks in income tax=14,321 gold marks in 1921. The total charge was therefore 27,821 gold marks.

Example 2. Let us assume the income from dividends in German companies, in 1920, to be 25,000 gold marks=375,000 paper marks and from foreign companies 25,000 gold marks, making a total of 50,000 gold marks=750,000 paper marks. Before distributing 375,000 paper marks, German companies had in 1920 to pay an average tax of 63,750 paper marks=4,250 gold marks. The 375,000 paper marks in German dividends due to the recipient were, upon receipt, reduced by 10 per cent, that is, by 37,500 paper marks=2,500 gold marks.

In 1920, therefore, 6,750 gold marks were paid in taxes. In 1921 the person drawing dividends had in the first place to pay a

10 per cent tax on revenue from capital on the 375,000 paper marks, that is, 37,500 paper marks = 1,506 gold marks. Furthermore, after deduction of the tax on revenue from capital, he had to pay on the remaining 675,000 paper marks an income tax of 356,600 paper marks = 14,321 gold marks. In this case the 1921 taxes thus amount to 15,827 gold marks. Including the 1920 taxes the total charge is therefore 22,577 gold marks.

II. *For 1923-24.* It is assumed that the dividends for 1923 have been distributed to the shareholders. In the total prior charge the tax on fortunes has not been taken into account. Only the corporation tax which under the Law of March 20, 1923, on the Depreciation of Currency was paid by the company for the business year 1922, which year was taken as the basis for the distribution of dividends, has been indicated as the prior charge. On the basis of the tariff the prior charge amounted to 45 per cent. Owing, however, to the great depreciation of currency in 1923, the gold value on the date of payment was insignificant. The prior charge has been indicated, therefore, at only 3 per cent, since the dollar rate at the time of the payment of the tax, that is, on April 25, amounted to 29,200, namely, about fifteen times the average dollar rate for 1922 (1885.78). In many cases, owing to delay in closing the balance sheet and to the consequent delay in paying the taxes, the prior charge was, as a result of the rapid depreciation of currency, much less than 3 per cent. In the case of the person receiving dividends the tax indicated is that which he had to pay as increased prepayments and payment of balance for 1923.

Since there was no proper assessment for income tax on a sliding scale for 1923, the payments of balance for 1923 have been determined according to the taxpayer's capacity to pay on the basis of his gold mark payments in 1923, and in certain cases on the basis of a lavish expenditure.

If, on the basis of the material at its disposal, the Finance Office can assume that the taxpayer had a gold mark income of 50,000 or 100,000 marks, a charge of at least 25 per cent may be allowed for.

If there are really cases of still higher incomes, a charge of 35 per cent on 500,000 gold marks and of 40 per cent on 1,000,000 gold marks will be paid. The total charge, therefore, amounts to 28 per cent in the case of incomes of 50,000 and 100,000 gold marks derived from dividends paid by German companies; if half of the income is derived from foreign companies half of the prior charge constituted by the corporation tax does not come into consideration

and the total charge therefore amounts to $25\frac{1}{2}$ per cent. For incomes of 500,000 gold marks the total charge represents 38 per cent or $36\frac{1}{2}$ per cent, for 1,000,000 gold marks 43 per cent or $41\frac{1}{2}$ per cent.

III. *For 1924-25.* It is assumed that the dividend for 1924 is distributed to the shareholders. The prior charge indicated is the tax which the company has paid as corporation tax prepayments and payment of balance for 1923.

The example of 50,000 gold marks has been calculated as follows: 1 gold mark was 449 paper marks according to the average rates of exchange of the dollar for 1922; 50,000 gold marks, therefore, equal 22,450,000 paper marks.

First prepayment (under the Currency Depreciation Law of March 20, 1923), 20 per cent = 4,490,000 paper marks, paid on May 25 (1 gold mark = 12,190 paper marks) = 369 gold marks.

Second prepayment (under the Law for Increases of July 9 to August 11, 1923), 600 times 10 per cent = 1,347 million paper marks, paid on August 25 (value of the gold mark = 1,120,000) = 1,203 gold marks.

Payment of balance on January 10, 1924 (under Article 1, §2, of the Second Fiscal Emergency Decree) 0.60 gold mark on each 1,000 marks of the 1922 fiscal debt; the 1922 fiscal debt in respect of dividends amounted to 45 per cent of the sum of 22,450,000 paper marks indicated above, that is, to 10,102,500 paper marks. Consequently the final payment of 0.6 per thousand in gold = 6,061 gold marks. The total prior charge, therefore, amounts to 7,633 gold marks.

In the case of the person receiving the dividend, the only payments demanded are those to be paid as income tax prepayments and as tax on fortunes in 1924. Ten per cent only is first deducted at the source from the revenue from investments as income tax prepayment; this is, therefore, 5,000 gold marks on 50,000 gold marks. For the tax on fortunes it is assumed that the dividends paid by German companies average 1 per cent of the quoted value; even this computation must, however, be too high for a great many German companies at the present time.

In the case of foreign companies it is assumed that the dividends amount to 5 per cent of the quoted value of the share. Fifty thousand marks in dividends from German companies therefore represent a quoted value of 5 million marks.

For the shareholders' payments in respect of the tax on fortunes this is valued at only half the quoted value, that is, $2\frac{1}{2}$ million marks,

since the company itself has to pay a tax on fortunes for which the fortune is assumed to be at least the total quoted value of the shares.

On a total fortune of $2\frac{1}{2}$ million marks the tax on fortunes amounts to 17,500 marks. The provisional charge on an income of 50,000 marks from dividends from German companies is therefore as follows:

	Gold marks
Tax on corporations.....	7,633
Deduction at the source from revenue from investments.....	5,000
Tax on fortunes.....	17,500
Total.....	30,133

If half the dividends come from a foreign company, the charge in respect of the tax on capital is as follows:

Twenty-five thousand marks from German companies. Quoted value, $2\frac{1}{2}$ millions (1 per cent interest), half of which is counted, that is, 1,250,000 marks.

Twenty-five thousand marks from foreign companies. Quoted value, 500,000 marks (5 per cent interest) counted in full, since the company does not pay the tax on fortunes in Germany.

The quoted value used for the tax on fortunes is, therefore, 1,750,000 marks and the sum paid in respect of the tax 11,375 marks.

As half of the dividends come from foreign companies, the deduction at the source on half the revenue from investments in this case also provisionally does not come into consideration. The Finance Office is, however, entitled to collect prepayments from the taxpayer with due consideration to his requirements. No sum is, however, included in the enclosed table on this account; for, as explained above, the calculations for 1924-25 constitute only provisional tax payments, which represent prepayments on the definitive income tax for 1924. For the 1924 income, the taxpayer will still be assessed at the beginning of 1925 and he will then have to make considerable postpayments, which are correspondingly higher in the case of income from foreign dividends from which no deduction at the source has been made in Germany. No sum could be included for postpayments, as the necessary regulations must first be enacted by law during the course of 1924 (in particular the rates of taxation).

Income in gold (Marks)	Definitive charge		Charge in respect of corporation tax and tax on fortunes; <i>non-re- current charge in</i> respect of income tax prepayments. 1924-25.
	Corporation tax, tax on revenue from capital, in- come tax. 1920-21.	Corporation tax. Income tax. 1923-24.	
50,000 ^a	27,821	14,000	30,133
50,000 ^b	22,577	13,250	17,691
100,000 ^a	57,586	28,000	60,266
100,000 ^b	47,098	26,500	37,133
500,000 ^a	295,707	190,000	313,830
500,000 ^b	243,267	182,500	194,415
1,000,000 ^a	593,357	430,000	627,660
1,000,000 ^b	488,477	415,000	388,830

^a German companies.

^b Half from German and half from foreign companies.

APPENDIX B

REPORT OF THE SECOND COMMITTEE OF EXPERTS

In pursuance of a decision of the Reparation Commission of November 30, 1923, we were created a Committee to consider the means of estimating the amount of German exported capital and of bringing it back to Germany. We were convened in Paris on January 21, 1924, and we have held altogether thirty-eight meetings, first in Paris, then in Berlin, and finally again in Paris. We have examined numerous witnesses and have availed ourselves of the services of trained economists, technical advisers and expert accountants. We have also studied the published works on the subject by well-known economists, and each member of the Committee has furnished reports on particular problems.

Our estimates relate to December 31, 1923. Later events may, of course, have either increased or decreased the amount of German capital abroad.

In our investigation of the amount of capital owned by Germans in foreign countries we were confronted by very considerable difficulties. There are many ways by which Germans can acquire capital abroad, but in most cases no precise figures can be given. It is nearly always a matter of estimate, and the utmost we could hope to do with any degree of certainty was to lay down limits between which the actual amount is to be found. The distance which divides these limits marks the want of precision of the material at our disposal.

One method of investigation, to institute an enquiry through bankers and business men in those countries in which German capital is believed to be deposited or invested, was rejected by us at the outset. We have availed ourselves of all information of a public

or official character supplied from countries outside Germany, but we were of opinion that it would be neither proper nor useful to request the disclosure of specific transactions which in general would have been entered into under an implied condition of secrecy. Moreover, we felt that even though all obtainable information were freely given to us, it must be extremely defective, as much German capital in foreign countries is certain in existing circumstances to be hidden in various ways under assumed names.

The method we have adopted is altogether different. Our first step was to form an estimate of the total value of German capital abroad at the outbreak of war.

Next we considered what was the net reduction in this total at the time of the Armistice. We took into account on one side the balance of trade, advances by Germany to her Allies, loss by seizure and sequestration of property confirmed by the Versailles Treaty, and loss through depreciation of the value of property and securities. On the other side we consider the sales of German securities, the sales of gold, the accumulation of interest, and finally the effect on the trade balance of the imports into Germany from occupied territories. These imports were commodities either requisitioned without payment, or paid for, in the case of Belgium and Poland, largely by marks which remained in the country, and, in Roumania and occupied France, as well as in Belgium and Poland, by local currencies which the German government caused to be printed and issued for the purpose.

Finally, starting from the basis of the remaining pre-war German assets, we examined in detail the various means by which Germans can have increased or diminished their capital abroad during the period from the Armistice to the close of the year 1923. The reliability of our final estimate depends upon the completeness of our examination of the different elements which make up the total of German foreign acquisitions and of the various ways in which such acquisitions may have been expended.

The chief method by which Germans have acquired foreign assets since the Armistice has been by the sale of mark bank balances. Our estimate of the total sum under this head has been obtained by a procedure founded upon the principle that every foreign sale by a German of a mark bank balance creates at the moment of sale a corresponding holding of a foreign bank balance in Germany. The periodic totals of foreign balances shown in the books of the German banks were disclosed to us; and with the assistance of expert

accountants we have been able to ascertain the net proceeds expressed in gold derived from the sale of marks. It is interesting to note that the foreign assets acquired in this way amounted to between seven and eight milliards of gold marks, the whole of which in consequence of the final devaluation of the mark was lost by more than one million foreigners who at one time or another were buyers of mark credits.

This figure is one of the credit factors in estimating the final total.

Other principal sources of German foreign assets have been the sale of goods, securities, real estate, precious metals and mark bank notes; interest accumulations, tourist expenditure in Germany, German holdings in ceded territories in Poland, Dantzic, etc., foreign money expended by the Allied Armies of Occupation, remittances from Germans abroad, earnings of shipping, railway and canal freights for foreign goods in transit through Germany, insurance profits, etc.

On the other hand, German foreign assets have been expended on the purchase of goods imported, cash payments to the Allies, interest paid on German securities held abroad, German tourist expenditure, etc.

On all these heads of receipt and expenditure the German statistical records and estimates, official data, bankers', and business reports, and other similar evidence, have been subjected by us to the most critical scrutiny, and their reliability has been tested by our examination of witnesses and inspection of original sources of information. Our investigations and the evidence obtained led us to discard entirely the values of German imports and exports as stated in the official reports, and to revalue all commodities on the basis of the then current world prices with such allowances as the special circumstances of German trade at the time may have rendered necessary.

After a close examination of all the factors which make up the total sum we are of opinion that German capital abroad of every kind, including capital of varying degrees of liquidity and capital invested in participations in foreign companies and firms, and after taking into account all credit and debit items was at the end of the year 1923 not less than 5.7 milliard gold marks and not more than 7.8 milliard gold marks and we think that the middle figure of 6.75 milliard gold marks is the approximate total.

We draw special attention to the foreign currency in Germany

which, though not included in our valuation of capital held abroad, is so closely akin to a foreign asset that it must not be overlooked. It may indeed be said that this currency, the total of which we estimate at not less than 1 milliard 200 million gold marks, is a German holding in the most liquid form for conversion into foreign assets.

On the other hand, on a broad view of German financial capacity, the value of the property in Germany held by foreigners should not be left out of account. The annual yield from this property, whether in the form of rent, interest or dividends, is at present inconsiderable and may at any time become subject to special taxation, particularly in the case of rent in respect of real estate purchased at the low prices current in recent years. We estimate, after very close study of the question, that the real estate and securities owned in Germany by foreigners represent a value of from 1 to 1½ milliard gold marks.

The Committee have thought it desirable to give in an annex to this report additional information in respect of their estimates of German assets abroad in 1914 as well as of the principal credit and debit factors, both during and since the war, that have gone to make up the final total of German capital abroad.

The second part of our enquiry was to investigate the means of bringing exported capital back to Germany.

The so-called flight of capital in this instance was in the main the result of the usual factors. It arose principally from the failure of the government to bring its budget into proper relation, and, as a corollary of such failure, from the raising of large loans and the direct issue of paper money. Secondly, it was due to the action of speculators and timid investors who sold their marks against the currency of other countries, while the exporters of goods retained abroad all that was possible of the proceeds of their sales. In the particular case under inquiry, however, the flight of capital was accentuated by the attitude of the people of Germany towards payments to her war creditors, and was marked by new and ingenious devices and schemes for evading restrictive legislation and for cloaking the real ownership of foreign balances.

The failure of the methods employed, both old and new, demonstrates the final ineffectiveness of restrictive legislation when successful evasion is so richly rewarded. Neither legal enactment nor severe penalties resulted in disclosure of assets abroad or hampered the flight of capital. We feel that this would have been true whether

the government had or had not used its best endeavors to enforce the laws and regulations.

In our opinion the only way to prevent the exodus of capital from Germany and to encourage its return is to eradicate the cause of the outward movement. Inflation must be permanently stopped. If the issue of currency is strictly confined within the true limits of national requirements on a stable basis of value, the German with capital abroad will feel assured that he will suffer no loss in bringing it home; the speculator can no longer look for a profit from the sale of marks. We have already seen in the case of Austria how, when the currency is fairly stabilized, the necessities of foreign trade tend to bring back existing foreign balances. Restrictive legislation, which in the main has proved futile in preventing the export of capital, becomes superfluous the moment there is no longer any inducement to evade the law. It is indeed to be feared that laws purporting to compel the return of capital would have the reverse effect to that which might be wished.

The method of securing a currency in Germany capable of maintaining a sufficiently stable international value covers the whole question of budgetary equilibrium and the establishment of a bank of issue on a sound basis. These matters, which fall outside the scope of our enquiry, have been referred by the Reparation Commission to another Committee whose conclusions we have the advantage of knowing. If effect is given to their recommendations, we think that a considerable part of the German assets now in foreign countries will return in the ordinary course of trade.

While we are of opinion that special legislation to prevent the export of capital or compel its return is not required when a country's finance is on a stable basis, we recognize that in the case of Germany a period of transition must necessarily ensue before stability can be obtained and confidence restored. We suggest that during this period an amnesty should be granted for a limited time from the penalties imposed by existing enactments and that special terms be offered for subscriptions to Government loans made in foreign currencies. Well-conceived measures of this kind would be helpful in hastening the return of capital and the final restoration of financial equilibrium in Germany, conditions which are essential to the payment of reparation.

We desire to express our sincere thanks to the officers of the Reparation Commission, and to the economists, statisticians and

expert accountants who have aided us, for whose valuable assistance we are greatly indebted.

April 9, 1924.

REGINALD MCKENNA, *Chairman.*

HENRY M. ROBINSON.

ANDRÉ LAURENT-ATTHALIN.

MARIO ALBERTI.

ALBERT-E. JANSSEN.

ANNEX

SUMMARY

I. ASSETS ABROAD IN 1914.

II. PERIOD OF THE WAR:

- a.* Surplus of imports and Germany's advances to her Allies;
- b.* Depreciation of pre-war foreign assets; sequestration and liquidation measures;
- c.* Profits realized by Germany in occupied territories;
- d.* Sale of gold and German securities;
- e.* Return from German assets abroad.

III. POST-WAR PERIOD:

- a.* Surplus of imports and cash payments made by Germany under the Peace Treaty;
- b.* Sales to foreigners of mark credits and bank notes;
- c.* Sales of gold;
- d.* Sales of German real property and German securities;
- e.* Expenditure by foreigners travelling in Germany and by Germans travelling abroad;
- f.* Expenditure by the Armies of Occupation;
- g.* Earnings from shipping, insurance, transit, etc.;
- h.* Income from German investments abroad and from foreign investments in Germany; remittances made by Germans residing abroad;
- i.* German private property in ceded territories;
- j.* Foreign bank notes in Germany.

I. ASSETS ABROAD IN 1914

The value of German assets abroad in 1914 has been estimated by different economists at sums varying between 20 and 35 milliard

gold marks. Beside these unofficial estimates two estimates of an official nature, as well as a census, have been made by the German government. The earlier of these two official estimates is that made in 1905 by the Imperial Admiralty; the later one was supplied by the German government in 1924 in reply to a question raised by the Second Committee of Experts. The census, which only covered securities, was made by the German government during the war, in August, 1916.

In the question put to the German government the Committee not only asked for an estimate of the foreign assets held by German nationals in 1914, but also requested it to submit its comments on the various estimates already made by German economists.

All these documents—estimates of German economists, and those of neutral, Allied and Associated countries, official estimates and census, and the replies of the German government—have been examined and compared. Taking into account all the factors of valuation, the Committee has come to the conclusion that the figure of 28 milliard gold marks may be accepted as representing the value of German assets abroad at the time of the declaration of war, it being understood that this figure of 28 milliards comprises only the assets abroad belonging to German nationals, residing in Germany and not those belonging to German nationals residing abroad. In this estimate securities have been taken at their face value in gold marks.

II. PERIOD OF THE WAR

a. SURPLUS OF IMPORTS AND GERMANY'S ADVANCES TO HER ALLIES

The difficulty encountered by Germany in exporting her goods during the war, as well as her persistent endeavors to increase her imports by every possible means, in order to provide for the requirements of her armies, naturally produced a surplus of imports, considerably in excess of the figures of the normal pre-war deficit. To this deficit in Germany's foreign trade balance must be added the sums advanced by Germany to her Allies to enable them to pay for their imports, for which she received no corresponding return. The figure indicated for these two items may be considered to be reliable and amounts to an aggregate sum of 15.2 milliard gold marks, subject to the modifications referred to in paragraph c.

b. DEPRECIATION OF PRE-WAR FOREIGN ASSETS; SEQUESTRATION AND LIQUIDATION MEASURES

Various estimates of the reduction in German assets abroad during the war as a result of depreciation have been made by several economists, whose figures are generally based on an estimated total of from 20 to 25 milliard gold marks for German assets in 1914. Their estimates seem too low, if we take as a basis the figure of 28 milliards adopted by the Committee for German assets abroad in 1914. This impression is moreover confirmed by information which the Committee has obtained by its own investigation.

It is impossible to adopt a definite figure in determining the value of the assets seized and liquidated in the Allied and Associated countries. On the basis of information obtained by the Committee from the governments of the Allied and Associated Powers as well as from Germany, the Committee has been able to estimate at approximately 16.1 milliard gold marks the reduction in German assets abroad during the war, as a result of depreciation and liquidation and sequestration measures. In adopting this figure no allowance has been made for the fact that certain German assets abroad may have been utilized to cover the payment of imports, nor for the fact that German assets abroad may have increased owing to the accumulation of the interest accruing on these assets. These several items are discussed elsewhere. The above figure therefore represents a net reduction in German assets abroad for which Germany during the war period received no return. These assets underwent a further decrease in value during the period following hostilities, which decrease was taken into account.

Lastly, the Committee is of opinion that both during and since the war the category of assets in neutral countries has likewise undergone a reduction in value, and that in particular the greater part of such securities held by Germans has no longer a value equivalent to their face value, even taking into account the effect of the decline in the value of gold.

c. PROFITS REALIZED BY GERMANY IN OCCUPIED TERRITORIES

An examination of German economic measures taken in Belgium during the war, to which the attention of the Committee was called, suggested that substantial profits had accrued to Germany from the exploitation of occupied territories. Consequently, the Com-

mittee has made a careful study covering not only German operations in Belgium and Northern France, but also those in Poland and Roumania.

No attention has been paid to the purely military aspects of these operations, such as, for instance, requisitions intended to provide for the partial subsistence of the German occupying troops. Quite apart from such matters, however, it was found that the profits realized by Germany by requisitions and by other methods in occupied territories are closely connected with the deficit of the German balance of trade. With the help of German official documents, in particular reports by the military administration drawn up during the war and German memoranda estimating the value of war damages, the Committee has ascertained that the profits realized by Germany were principally obtained as follows:

Germany obtained in occupied territories considerable quantities of commodities which through the operation of centralized importing companies specially created for this purpose, were transported to Germany for internal consumption. Most of these goods were either not paid for at all, or were paid for in paper marks which were subsequently left in the country and amounted in the case of Belgium to six milliard paper marks, or were purchased through the medium of issues of local paper currency. The special object of such issues, according to a statement by the German Staff, was to enable Germany and her Allies to receive goods from occupied territories free of charge during the whole period of hostilities.

By requisition or in exchange for paper marks or local currency Germany also obtained considerable quantities of the currency of invaded countries. Thus in the north of France the German military authorities imposed on towns fines and levies for which payment was required in German money, gold coin, or notes of the Bank of France.

Finally, foreign assets were acquired by Germany, specially in Belgium and France, notably by means of sequestration of securities, coupons and other credits, and these, like the bank notes mentioned above, served in part to pay for imports from neighboring neutral countries.

It must also be pointed out that when the German Coal Centrale in Belgium issued export licenses for coal for Holland, Switzerland, or Sweden, the German authority kept for itself the foreign currency thus obtained, and forced the mines to accept paper marks.

The Committee has adopted the figure of from 5.7 to 6 milliard

gold marks as corresponding to that portion of the profits derived from this exploitation of Belgium, Northern France, Poland, Lithuania, Roumania, etc., representing imports for which no payment was made and which in consequence had not been allowed for in her balance of accounts.

d. SALE OF GOLD AND GERMAN SECURITIES

The sale of gold and securities was the principal means whereby Germany paid for her imports during the war. The export of gold, which took place mainly during the early years of the war, reached a total amount of one milliard gold marks.

As regards German securities, widely diverging estimates have been made of the amounts sold. In our opinion the total figure is not far from one milliard gold marks.

e. RETURN FROM GERMAN ASSETS ABROAD

The revenue which Germany derived from her assets abroad was very considerably diminished immediately after the declaration of war and further reductions occurred during the period of hostilities.

It should indeed be noted that interest ceased to be paid on the assets held by Germany in countries with which she was at war. Some of these assets were sold during the war and the depreciation of others became very marked towards the end.

On the other hand, the industrial securities, particularly those of neutral countries continued to pay interest at rates frequently higher than before the war.

While the Committee has been unable to determine exactly the variations for each year of the war in the revenue derived from German assets abroad, it has at least been able to make an estimate which may be taken as very nearly accurate.

III. POST-WAR PERIOD

a. SURPLUS OF IMPORTS AND CASH PAYMENTS MADE BY GERMANY UNDER THE PEACE TREATY

One of the main causes of the reduction of German assets abroad during the post-war period arose from the necessity for Germany to cover the deficit in her trade balance and to meet the cash payments which had to be made to the Allies under the Treaty of

Versailles. These two items together amount to between 9 and 10 milliard gold marks.

As already stated in the report, the figures given in the official German foreign trade statistics are quite inaccurate for certain periods. This observation applies particularly to the figures originally published.

For this reason it was necessary to revise completely the balance given for every year. Taking into account the various factors entering into the calculation, the Committee is of opinion that this revision has made it possible to reach a figure more nearly equal to the actual excess of imports than had been the case in previous reports dealing with this question. The fixing of the amount of the deficit in the trade balance is of true importance since any valuation that is to be made of German assets remaining abroad largely depends on the figure finally adopted for that deficit.

The cash payments made by Germany to the Allies—to the Reparation Commission, under the Reparation Recovery Act, payments to the Clearing Office, etc.—do not give rise to dispute.

b. SALE TO FOREIGNERS OF MARK CREDITS AND BANK NOTES

Germany has acquired foreign assets in large volume since the Armistice through opening credit accounts in her banks for the benefit of foreigners. These credits were paid for by the foreigners in the money or credits of other countries, and as they underwent a constant shrinkage in real value through the depreciating value of the mark, German economy profited largely from the transactions. The Committee made a careful study of the values so acquired by an investigation, with the aid of expert accountants, of the mark credit balances on foreign account in the principal banks of Germany during the post-war years.

It was found that there had been during this five-year period more than a million individual accounts of this kind. In most cases the mark credits of these accounts had not been immediately utilized and had undergone a process of shrinkage through the depreciation of mark values that amounted to a veritable evaporation.

The work of the expert accountants was directed to determine as nearly as possible the aggregate amount of the shrinkages in these very numerous accounts that was due to the depreciation of the value of the mark. With this end in view the leading banks in

Germany were asked to transcribe from their books the data showing the credit balances and the amounts of debits in the accounts of all foreigners at the close of each month from the end of 1918 to the end of 1923.

After the sums indicated had been converted to gold equivalents at the current rate of exchange it was possible to draw close inferences as to the total gains accruing to German economy as a whole. The data furnished by the banks were submitted to careful checking by the expert accountants, and it was found that they had been correctly compiled.

Credits in German marks were purchased by the citizens of a great many nations, but the largest amounts were taken by the citizens of a relatively restricted group of countries.

The methods used in determining the value of the assets acquired by the German banks in this way were subjected to an interesting check which consisted of taking a single account of a foreigner who had engaged in speculative operations on a considerable scale, and converting the figures of the transactions to a gold basis for every day on which any debit or credit entry was recorded. The results indicated that there was no tendency for this detailed method of conversion to yield results materially different from those found by the more general mass methods that it was necessary to employ in computing the figures for Germany as a whole.

When the whole enquiry, which was of considerable length, had been completed it was found that Germany had profited by the sale of mark credits by an amount of from 7 to 8 milliards of gold marks. In addition the sale of paper marks in foreign countries had resulted in profits amounting to from 600 to 700 millions of gold marks, or a total from these two sources of 7.6 to 8.7 milliards of gold marks.

c. SALES OF GOLD

German official statistics record sales abroad by Germany principally in the years 1919-21 and 1923 of gold to a total amount of $1\frac{1}{2}$ milliard gold marks. The accuracy of these figures is not disputed.

d. SALES OF GERMAN REAL PROPERTY AND GERMAN SECURITIES

During the period characterized by the rapid depreciation of the mark, sales of real property to foreigners reached an unwonted development in Germany.

In estimating the proceeds of such sales, the Committee had before it various statistics indicating in detail the number and amount of sales of real property to foreigners since the war in some of the principal towns of Germany, and also in districts of varying economic character.

As regards securities, Germany was able during the first part of the post-war period to market some of her securities abroad, but as soon as her financial position became more uncertain, most of these transactions were suspended.

In the aggregate, the Committee considers that sales of German real property and securities to foreigners amounted to about 1½ milliard gold marks.

e. EXPENDITURE BY FOREIGNERS TRAVELLING IN GERMANY AND
BY GERMANS TRAVELLING ABROAD

During the five years which have elapsed since the Armistice considerable sums have been spent in Germany by large numbers of foreigners who have travelled and lived in the country. Our estimate of the expenditure by these travellers was facilitated by the official statistics kept by the largest German towns and by the special report on the subject supplied by the German government. The Committee was able to obtain a fairly exact idea of the number of foreigners who came to Germany during the period in question, the average length of their stay and the daily expenditure of each traveller.

As against this, numerous German travellers belonging mostly to the wealthier classes have stayed in foreign countries, especially in the last two or three years. Their expenditure has to be deducted from the expenditure by foreigners in Germany referred to above, and very considerably reduces the amount of the German assets realized from that source.

f. EXPENDITURE BY ARMIES OF OCCUPATION

During the post-war period a certain sum has been realized by Germany through the expenditure in foreign currency, or in marks bought with foreign currency, by the troops occupying German territory.

Each of the governments having or having had armies of occupation in Germany has supplied the Committee with a detailed estimate

of the expenditure made by the officers and men or by the various army services. These estimates were checked in several ways by a series of calculations relating to each army's different methods. The results of these different calculations have been combined.

g. EARNINGS FROM SHIPPING, INSURANCE, TRANSIT, ETC.

Earnings from shipping, insurance, commissions, transit, were an important source of German income prior to 1914, but during the war such earnings in great measure disappeared. In the five years 1919-23 some of the lost ground has been regained, particularly in the field of shipping and insurance, and the Committee has taken this item into account.

h. INCOME FROM GERMAN INVESTMENTS ABROAD AND FOREIGN INVESTMENTS IN GERMANY—REMITTANCES MADE BY GERMANS RESIDING ABROAD

The total amount of the income produced by German assets abroad since 1919 is of course substantially below that produced by German assets abroad before the war. The assets held abroad by Germany since the war represent indeed only a small and for some part unproductive fraction of her pre-war holdings. It is true, on the other hand, that the payments which Germany has had to make since 1919 in respect of German securities held by foreigners have been inconsiderable. After a careful study of the question the Committee came to the conclusion that a set-off of the two items—income from German investments abroad and income from foreign investments in Germany—resulted in a small balance in Germany's favor for the whole of the post-war period.

The remittances sent to Germany by German nationals residing abroad and German connections and sympathizers amount to a considerable figure in Germany's favor.

i. GERMAN PRIVATE PROPERTY IN CEDED TERRITORIES

Most of the valuations of German property abroad have taken little or no account of the value of German private property in the ceded territories of Silesia, Posen, Danzig, etc.

These properties are included in our own estimate in so far as, according to the definition adopted by the Committee, they are

owned by Germans residing in Germany. Although it is very difficult to determine with any precision the extent of these properties, the Committee considered that it should not exclude from its valuation certain industrial assets, particularly those in Upper Silesia.

j. FOREIGN BANK NOTES IN GERMANY

There is in Germany a large quantity of foreign bank notes (dollars, florins, Scandinavian crowns, Swiss francs, pounds sterling, and more especially in the occupied territory, Belgian and French francs). The exceptional plight of the German mark has influenced Germans in acquiring stable currencies wherever possible and on a large scale. These foreign notes have remained in the country instead of finding their way abroad again through the normal channel of trade, as would have been the case in ordinary circumstances.

Various estimates of the total amount of such notes were made in Germany, particularly towards the end of 1923. The Committee has compared the different estimates with the information which it collected in Germany and other countries. In its opinion, the value of the foreign notes existing in Germany at the end of 1923 amounted to about 1.2 milliard gold marks.

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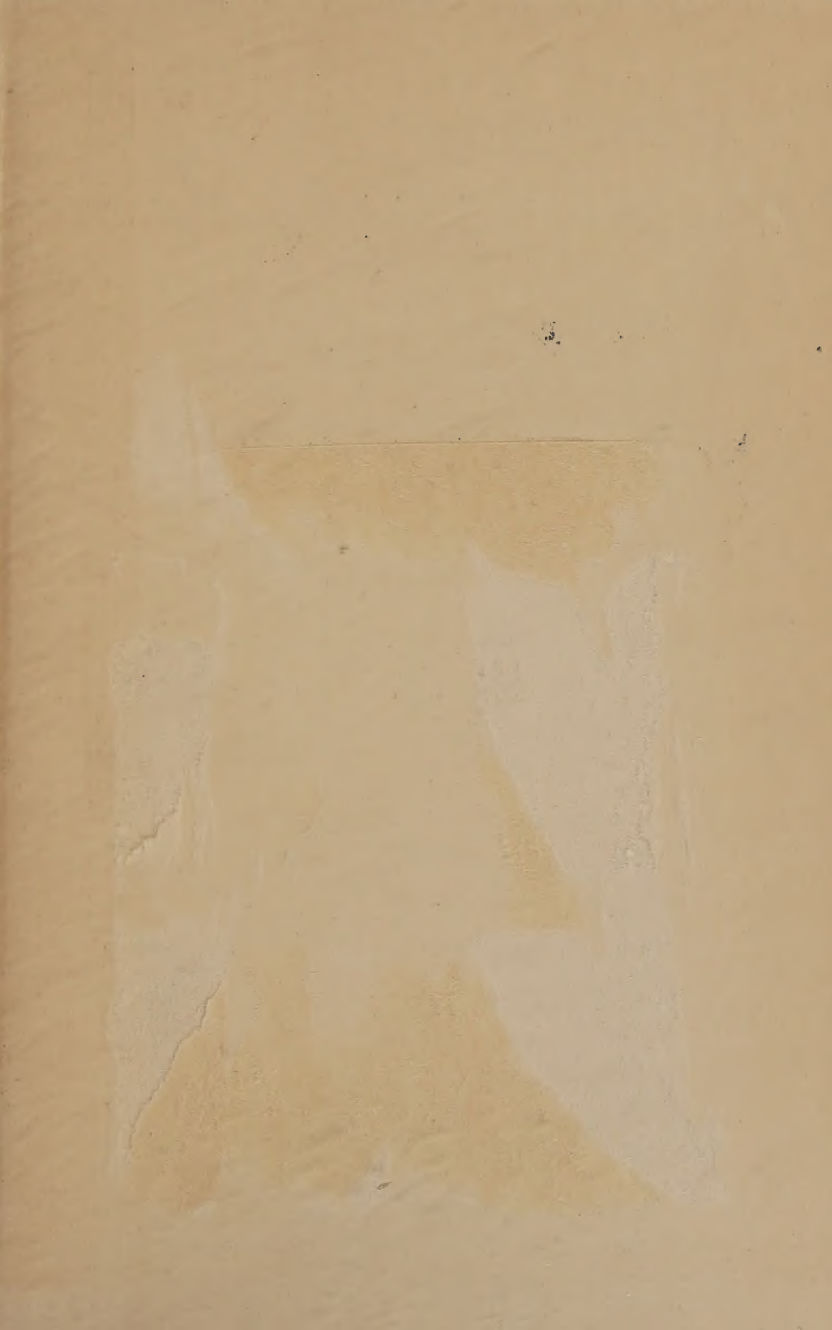
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